INFLATION REPORT / IV

2011

CZECH NATIONAL BANK

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In 1998, the Czech National Bank switched to inflation targeting. In the inflation targeting regime, the central bank's communication with the public plays a significant role. One of the core elements of this communication is the publishing of quarterly Inflation Reports. Section II of the Inflation Report contains a description of the Czech National Bank's new quarterly macroeconomic forecast, and section III presents its assessment of past economic and monetary developments.

The inflation forecast and the assumptions underlying it are published with the aim of making monetary policy as transparent, comprehensible, predictable and therefore credible as possible. The Czech National Bank is convinced that credible monetary policy effectively influences inflation expectations and minimises the costs of maintaining price stability. Maintaining price stability is the Czech National Bank's primary objective.

The forecast for the Czech economy is drawn up by the CNB's Monetary and Statistics Department. The forecast for inflation at the "monetary policy horizon" (about 12–18 months ahead) is of greatest relevance to the decision-making on the current interest rate settings.

The forecast is the key, but not the only, input to the Bank Board's decision-making. At its meetings during the quarter, the Bank Board discusses the current forecast and the balance of risks and uncertainties surrounding it. The arrival of new information since the forecast was drawn up and the possibility of asymmetric assessment of the risks of the forecast and divergent views of some board members on the development of the external environment or the linkages between the various indicators within the Czech economy mean that the Bank Board's final decision need not correspond to the message of the forecast.

This Inflation Report was approved by the CNB Bank Board on 10 November 2011 and contains the information available as of 21 October 2011. Unless stated otherwise, the sources of the data contained in this Inflation Report are the CZSO or the CNB. All the Inflation Reports published to date are available on the CNB website. Underlying data for the tables and charts presented in the text of this Inflation Report, minutes of Bank Board meetings, and time series of selected economic and monetary indicators (available in the ARAD database) are published at the same internet address.

CHART I.1

FULFILMENT OF THE INFLATION TARGET

Headline inflation was just below the CNB's inflation target in 2011 Q3
(annual percentage changes)

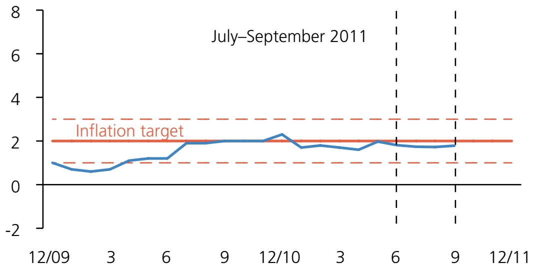


CHART I.2

HEADLINE INFLATION FORECAST

Headline inflation will temporarily rise to just above 3% in 2012 owing to a VAT increase
(annual percentage changes)

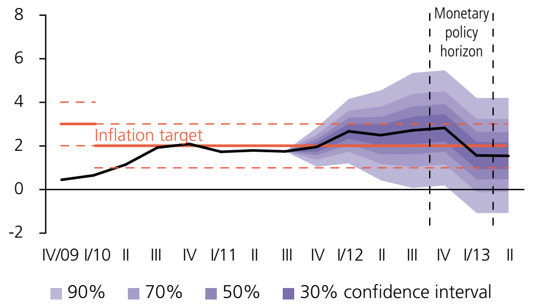
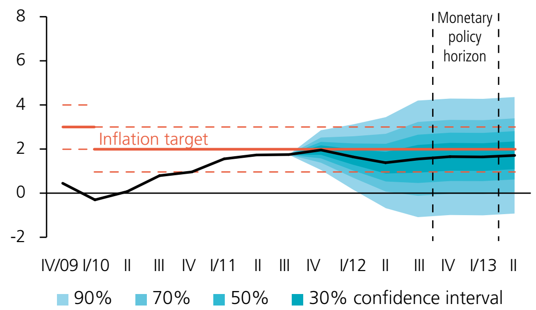


CHART I.3

MONETARY-POLICY RELEVANT INFLATION FORECAST

Monetary-policy relevant inflation will be slightly below the target over the entire forecast horizon
(annual percentage changes)



I. SUMMARY

In 2011 Q2, the growth of the Czech economy, which until then had been driven mainly by net exports, recorded a downswing. This confirmed the start of a downward phase, as predicted in the previous forecast. Headline inflation and monetary-policy relevant inflation are both just below the target. The inflation pressures from the domestic economy are not significant and commodity prices remain the main source of inflation. GDP growth will slow further next year. Its pace will be dampened chiefly by lower external demand growth. Real economic activity will increase significantly only in 2013. Monetary-policy relevant inflation will be slightly below the target over the entire forecast horizon. Headline inflation will rise temporarily to just below 3% in 2012 owing to a VAT increase, but will fall back below the target at the start of 2013. The second-round effects of the VAT increase are not expected to be significant. Consistent with the forecast is a slight decline in market interest rates at the start of the forecast and flat rates until late 2012/early 2013. The main risk to the forecast relates to the situation abroad and is described in an alternative scenario entitled "euro area stagnation".

The **annual rate of growth of the Czech economy** slowed noticeably to 2.2% in 2011 Q2. This was chiefly due to net exports (which, however, remain the main driver of growth) and, to a lesser extent, to a deeper decline in household and government consumption. By contrast, the positive contributions of fixed investment and inventories increased. A further slowdown in annual growth to 1.7% is expected in 2011 Q3.

Headline inflation was just below the CNB's target in 2011 Q3 (see Chart I.1). Monetary-policy relevant inflation merged with headline inflation at the start of 2011 Q3 as the final lagged effects of last year's increase in indirect taxes disappeared. Global commodity prices and food prices are still the main source of inflation, although the growth in food prices is now slowing. Adjusted inflation excluding fuels remains negative and continues to reflect weak domestic demand and subdued domestic inflationary pressures. Margins are close to their long-term levels amid weak overall growth in costs. By contrast, import prices are inflationary, with the continuing rise in global prices being magnified by the current depreciation of the koruna's exchange rate.

Economic growth in the euro area started to fall in 2011 Q2 and should be slightly lower than in 2010 for the year as a whole (at 2.6%). Next year, however, the rate of growth is expected to decrease significantly. The escalating debt crisis in the euro area has led to a marked downward revision to the market outlook for 3M EURIBOR rates. The path of foreign rates shows a decline of about 0.5 percentage point from the current levels in late 2011 and early 2012 and a long period of stagnation thereafter. The outlook for interest rates and the escalation of the debt crisis in the euro area are reflected in an expected gradual weakening of the euro against the dollar. Prices of oil and other commodities remain relatively high. However, a steady decrease in prices on the commodity markets is expected in the longer run.

According to the forecast, headline inflation will rise temporarily to just below 3% in 2012 owing to a VAT increase. At the start of 2013 it will fall below the target (see Chart I.2). **Monetary-policy relevant inflation**, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, will be slightly below the target over the entire forecast horizon (see Chart I.3). Its modest decrease at the start of the forecast horizon will be fostered by slower growth in economic activity and lower annual commodity price inflation. Administered prices and cost pressures from the domestic economy – which are gradually strengthening in the longer run and are linked with a steady acceleration in wage growth and low labour productivity growth – will initially act in the opposite direction. These domestic pressures will be partly offset by gradual appreciation of the exchange rate and by the unwinding of commodity price growth, which are factors that will manifest themselves mainly in lower annual food and fuel price inflation. The second-round effects of the VAT increase are not expected to be significant. Adjusted inflation excluding fuels will gradually rise and turn positive in 2012 Q2.

Consistent with the forecast is a slight decline in market **interest rates** at the start of the forecast and flat rates until late 2012/early 2013 (see Chart I.4). The fall in 3M PRIBOR rates at the start of the forecast horizon is due mainly to a decline in foreign interest rates expected by the market and to low domestic demand. Interest rates do not react to the expected temporary rise in inflation above the target caused by the first-round effects of the changes to indirect taxes. The forecast expects the **koruna-euro exchange rate** to appreciate gradually from its present weak level owing mainly to the low foreign interest rate level expected by the markets (see Chart I.5). The forecast considers the depreciation at the end of this year to be a temporary shock caused by a short-term increase in the risk premium due to the European debt crisis, after which the exchange rate will correct rapidly. The gradual renewal of long-term real convergence will also foster appreciation of the koruna in the longer run.

The **growth of the Czech economy** will slow further this year owing to fading investment in inventories and to fiscal consolidation, which will be joined by a decline in external demand (see Chart I.6). The main source of growth, which will reach 2.0% for the year as a whole, will be net exports. GDP growth will slow more markedly in 2012 (to 1.2%), when net exports will make a negative contribution owing to a downturn abroad, whereas domestic demand will grow slightly. In 2013, real economic activity will increase more strongly, with positive contributions from both domestic demand and net exports. On the **labour market**, the aforementioned developments will cause total employment to show subdued growth this year and a stagnation thereafter. Employment will start edging up in 2013. This will be reflected in a decline in the unemployment rate. Wage growth in the business sector will gradually rise and wages in the non-business sector will also start increasing at a subdued rate in 2012.

CHART I.4

INTEREST RATE FORECAST

Consistent with the forecast is a slight decline in market interest rates at the start of the forecast and flat rates until late 2012/early 2013

(3M PRIBOR, %)

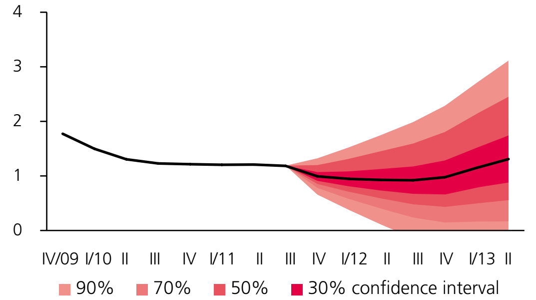


CHART I.5

EXCHANGE RATE FORECAST

The nominal exchange rate will start to appreciate again at the start of 2012

(CZK/EUR)

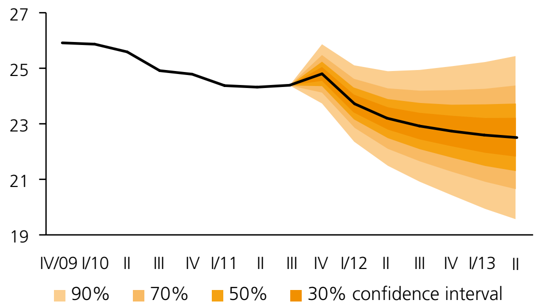


CHART I.6

GDP GROWTH FORECAST

GDP growth will slow sharply until the start of 2012 and then start to accelerate again

(annual percentage changes; seasonally adjusted)

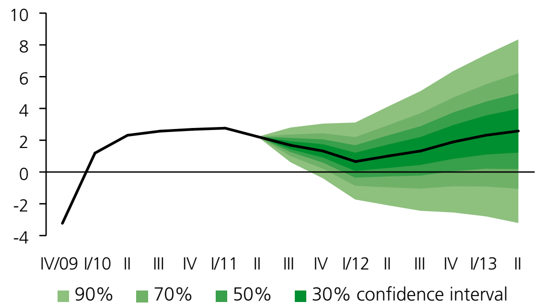


CHART I.7

GDP GROWTH FORECAST – COMPARISON OF BASELINE AND ALTERNATIVE SCENARIOS

The economic slowdown is much more significant in the alternative scenario; in 2012 GDP will even shrink slightly
(annual percentage changes; seasonally adjusted)

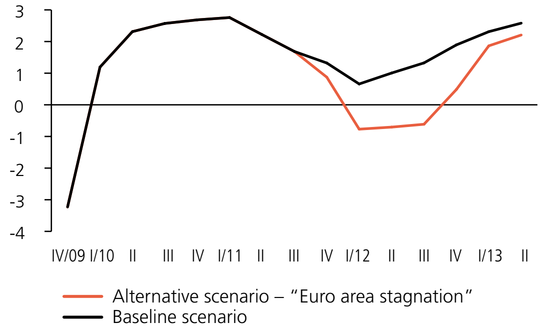


CHART I.8

EXCHANGE RATE FORECAST – COMPARISON OF BASELINE AND ALTERNATIVE SCENARIOS

The exchange rate is far weaker in the alternative scenario than in the baseline scenario
(CZK/EUR)

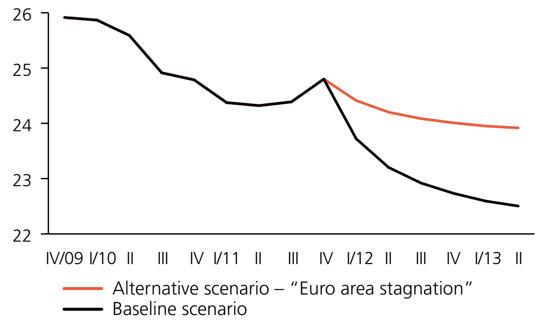
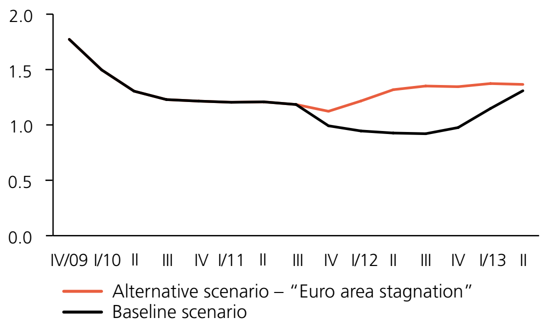


CHART I.9

3M PRIBOR – COMPARISON OF BASELINE AND ALTERNATIVE SCENARIOS

Interest rates are higher in the alternative scenario than in the baseline scenario
(%)



A risk related to the assumptions regarding the future external economic situation was identified in the forecasting process. Analysts are incorporating the current adverse developments associated with the escalation of the global debt crisis only gradually into their expectations of economic activity and inflation, whereas the market outlook for interest rates has been responding strongly and immediately. This combination of outlooks, which need not be mutually consistent, is exerting pressure for renewed fast appreciation of the koruna over the forecast horizon. However, this appreciation need not occur in reality in the event of a stronger-than-expected weakening of external and subsequently also domestic demand. This has led to the preparation of an **alternative scenario entitled "euro area stagnation"**. With regard to its assumptions about developments abroad, the scenario was created using the NiGEM model in such a way that it corresponds to the current low market outlook for 3M EURIBOR rates and calculates the corresponding outlooks for other variables. This scenario describes a marked GDP growth slowdown in the euro area in 2012 to almost zero on average, together with a faster fall in inflation. At the same time, it is associated with a slightly lower outlook for dollar oil prices and weaker euro-dollar exchange rate compared to the baseline scenario.

The aforementioned developments abroad lead to a more significant cooling of domestic economic activity (see Chart I.7) and a weaker exchange rate of the koruna (see Chart I.8), to which monetary policy responds with higher interest rates than in the baseline scenario, hence the rates do not fall in the near term (see Chart I.9). Czech GDP growth in 2012 is 1.6 percentage point lower than in the baseline scenario and therefore falls into slightly negative figures. In 2013 it is 0.4 percentage point lower. Headline and monetary-policy relevant inflation is little different from the baseline scenario, as the effect of weaker economic activity, lower wage growth and lower administered prices is offset by much slower appreciation of the koruna.

At its monetary policy meeting on 3 November 2011, the Bank Board decided by a majority vote to **leave interest rates unchanged**. The risks of the new forecast were assessed as being significant and tilted towards interest rate stability in the spirit of the alternative, "euro area stagnation" scenario. The downside risks to inflation include slower wage growth and a significant deterioration in expected foreign economic growth, including a further decline in the outlook for world commodity prices and 3M EURIBOR rates. By contrast, fulfilment of the alternative, "euro area stagnation" scenario and a weaker exchange rate of the koruna would foster higher inflation (higher interest rates than in the baseline scenario).

II THE FORECAST, ITS CHANGES AND RISKS

II.1 EXTERNAL ASSUMPTIONS OF THE FORECAST

Economic growth in the euro area for 2011 as a whole will slow slightly. A more substantial cooling is expected in 2012. External demand is expected to pick up again in 2013. The only slow unwinding of the effects of high commodity prices is reflected in a higher outlook for producer prices this year. Both producer price inflation and consumer price inflation will slow over the next two years. As a result of the escalating debt crisis in the euro area and growing concerns of a possible return to recession, the 3M EURIBOR rate is expected to come down in the near future. This represents a marked downward shift in the outlook compared to the previous forecast. Associated with this is an expected depreciation of the euro-dollar exchange rate. Concerns about a global economic downswing are also shifting the outlook for Brent crude oil prices towards lower levels.

The outlook for the **effective indicator of euro area GDP** foresees growth of 2.6% this year, i.e. 0.2 percentage point lower than in 2010 (see Chart II.1.1).[1] A marked slowdown is expected in 2012, for which the outlook for foreign economic activity has been lowered by 0.8 percentage point to 1.4%. A slowdown is also suggested by the latest data for 2011 Q2, when quarter-on-quarter growth virtually halted in most euro area countries, Germany and France in particular. Signs of an escalating debt crisis and growing risks to the entire euro area banking sector, where German and French banks play a key role, are still apparent in Q3. The risks of a restructuring of part of the periphery countries' debt are creating uncertainty for investment decision-making by economic agents and may worsen access to credit in the future. This, in turn, will probably have an adverse effect on economic activity. A foreign trade slowdown and a fall in domestic demand due to fiscal consolidation will further strengthen this dampening effect. A renewed pick-up in economic growth in the effective euro area is expected in 2013, when the rate of growth should reach 2%.

The so far slow unwinding of the effects of high commodity prices and still rising electricity and natural gas prices are reflected in the outlook for growth in the **effective indicator of producer prices**, which shifted upwards in 2011 (see Chart II.1.2). The estimate of the average annual growth rate this year was revised upwards by 0.6 percentage point to 5.8%. The outlook for 2012 and 2013 takes into account the gradual unwinding of high commodity prices; producer price inflation should be 2.4%.

1 The outlook for external variables is based on Consensus Forecasts (CF) and prices of market contracts, which were updated as of 10 October 2011. Their potential mutual inconsistency was the motivation for preparing the "euro area stagnation" alternative scenario, see section II.4. The outlook is indicated by the grey areas in the charts. This convention is used throughout this Report.

CHART II.1.1

EFFECTIVE GDP IN THE EURO AREA

The euro area economy is expected to slow sharply in 2012
(annual percentage changes; differences in percentage points – right-hand scale)

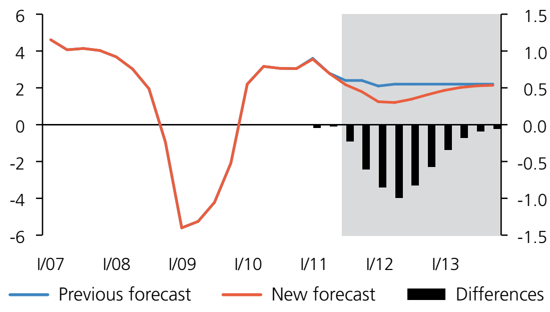


CHART II.1.2

EFFECTIVE PPI IN THE EURO AREA

Producer price inflation will slow as the effects of high commodity prices unwind
(annual percentage changes; differences in percentage points – right-hand scale)

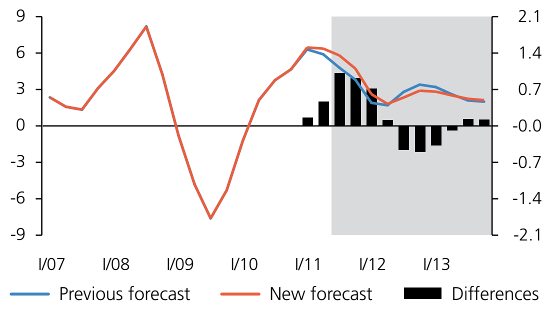


CHART II.1.3

EFFECTIVE CPI IN THE EURO AREA

Effective inflation will slow to 2% over the next two years
(annual percentage changes; differences in percentage points – right-hand scale)

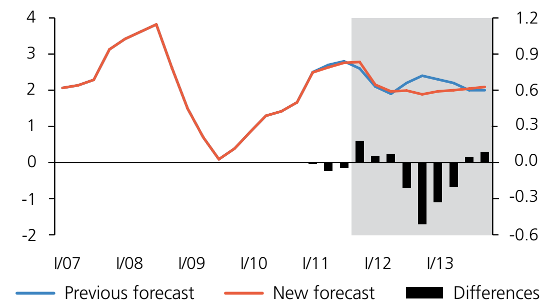


CHART II.1.4

3M EURIBOR

The expected slowdown in the euro area and the escalating debt crisis have shifted the market rate outlook downwards significantly

(in %; differences in percentage points – right-hand scale)

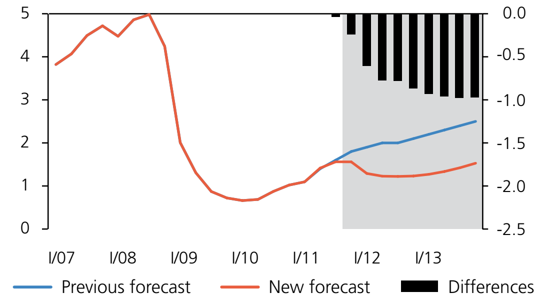


CHART II.1.5

EURO-DOLLAR EXCHANGE RATE

The uncertainty surrounding the solution to the euro area debt crisis is reflected in a weakening euro-dollar exchange rate

(USD/EUR; differences in % – right-hand scale)

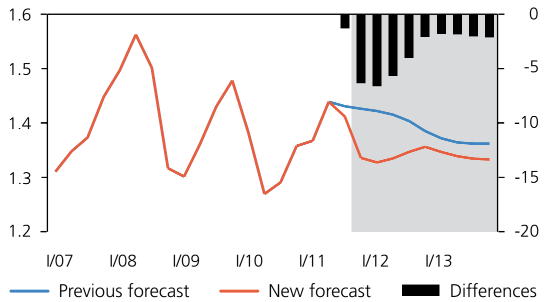
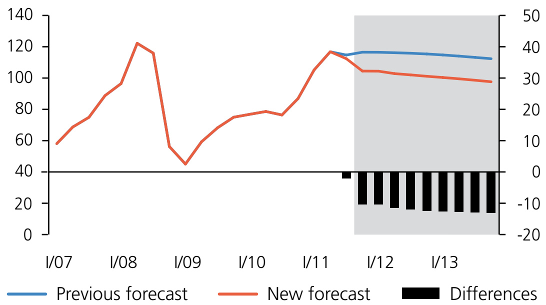


CHART II.1.6

PRICE OF BRENT CRUDE OIL

The expected global economic slowdown is reflected in a distinctly lower outlook for the price of oil

(USD/barrel; differences in % – right-hand scale)



The expected figures for economic growth and producer prices are reflected in the outlook for the **effective indicator of consumer prices in the euro area**. This indicator is the same as in the previous forecast, at 2.7% (see Chart II.1.3). Over the next two years, however, annual consumer price inflation is expected to fall to 2% in connection with the subdued demand expected in the euro area and the gradual unwinding of the effect of high commodity prices.

The escalating debt crisis in the euro area (Greece, Ireland, Portugal) and the growing risk of it spreading to other countries (Spain, Italy) in a situation of a clear slowdown in economic growth have led to a marked downward revision to the market outlook for **3M EURIBOR** rates (see Chart II.1.4). In late 2011 and early 2012, the path of foreign rates shows a decline from the current levels of around 1.5% to just above 1%. This outlook is in line with the expectations of CF analysts, who as from 2011 Q4 expect the ECB's main refinancing rate to be lowered from the current 1.5% to 0.5% at the one-year horizon. The reduced outlook also reflects the resumption of provision of long-term liquidity by the ECB. Modest growth in 3M EURIBOR is again predicted at the end of 2012. 3M EURIBOR should reach 1.2% on average in 2012 as a whole and 1.4% in 2013. This means a downward shift of 0.8 and 0.9 percentage point respectively compared to the assumptions of the previous forecast. According to CF analysts, the outlook for the 3M EURIBOR path also decreased, but the expected level is about 0.2 percentage point higher than the market outlook.

The course of the **euro-dollar exchange rate** recently has reflected negative investor sentiment vis-à-vis the European currency and has been closely linked with the escalating debt crisis in the euro area (see Chart II.1.5). The forecast thus expects the dollar to appreciate gradually from this year's average of USD 1.39/EUR to USD 1.34 in both 2012 and 2013. Compared to the previous forecast this means a strengthening of the dollar of about 3% on average.

The outlook for the **Brent crude oil price** based on market futures has also been revised downwards (see Chart II.1.6). The market outlook for this year has been revised only slightly, to USD 110 a barrel. The outlooks for 2012 and 2013 have both been lowered by USD 14 a barrel, to USD 102 and USD 99 a barrel respectively. Concerns about slowing growth of the global economy and the gradual calming of the political situation in Arab countries, especially Libya, can be regarded as the main causes of the expected lower oil prices in the next two years. Associated with this is the expected resumption of oil supplies from these countries to the European market in the near future.

II.2 THE FORECAST

Headline and monetary-policy relevant inflation were both 1.7% on average in 2011 Q3. Global commodity prices and food prices are still the main sources of inflation. Import prices reflect the lagged pass-through of high commodity price growth to foreign producer prices, and this factor has now been joined by depreciation of the koruna. Weak domestic demand and low wage growth mean that domestic inflationary pressures are not significant. Profit margins are close to their long-term level thanks to generally subdued costs. Headline inflation will rise temporarily to just below 3% in 2012 owing to a VAT change, but will fall back below 2% at the start of 2013. Monetary-policy relevant inflation will be slightly below the 2% target over the entire forecast horizon. This will be fostered by slower growth in economic activity and renewed exchange rate appreciation. The inflationary effect of commodity prices will also unwind. Modest inflationary pressures will arise only from administered prices and from a gradual pick-up in wage growth amid low labour productivity growth. The second-round effects of the VAT increase are not expected to be significant. GDP growth is expected to reach 2% this year. Economic growth is being dampened by fiscal restriction and generally weak domestic demand. GDP growth will decrease more strongly in 2012 to 1.2%, owing to subdued external demand. Consistent with the forecast is a slight decline in market interest rates at the start of the forecast and flat rates until late 2012/early 2013.

Annual **headline inflation** was 1.7 % on average in 2011 Q3, as was monetary-policy relevant inflation, i.e. inflation adjusted for the first-round impacts of changes to indirect taxes. Monetary-policy relevant inflation will be slightly below the inflation target over the entire forecast horizon. However, headline inflation will rise temporarily to just below 3% in 2012 owing to tax changes, but will fall below the inflation target in 2013 once their effect has subsided (see Chart II.2.1).

Annual **administered price inflation** rose to 4.5% on average in 2011 Q3. The forecast expects a further increase to 5.6% in Q4, mainly because of growth in natural gas prices and rents together with an expected jump in rail fares and prices of postal services. Administered price inflation will rise above 7% at the start of 2012 as a result of higher prices of energy for households, rents, and prices in healthcare. An increase in the reduced VAT rate in January 2012 will also contribute to the rise in administered price inflation. An expected decline in global prices of energy commodities and renewed exchange rate appreciation will start to affect administered prices in mid-2012. This, together with the unwinding of the effect of the VAT change, will cause annual administered price inflation to slip below 3% in 2013 (see Table II.2.1). [2]

2 The effect of the unification of the two VAT rates at 17.5% in 2013 will be weak overall (see Box 1 in Inflation Report III/2011).

CHART II.2.1

HEADLINE INFLATION AND MONETARY-POLICY RELEVANT INFLATION

Monetary-policy relevant inflation will be slightly below the inflation target, while headline inflation will be affected by tax changes in 2012 and 2013

(annual percentage changes)

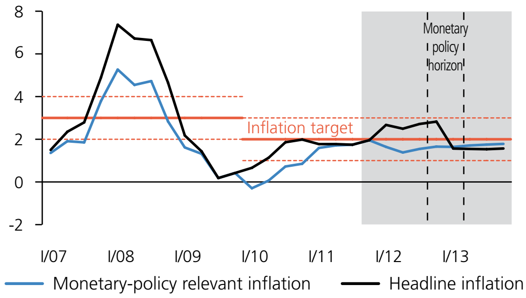


CHART II.2.2

ADMINISTERED PRICES AND FUEL PRICES

Administered price inflation will rise in 2012 owing, among other things, to an increase in VAT and energy prices

(annual percentage changes; fuel prices excluding first-round effects of indirect tax changes)

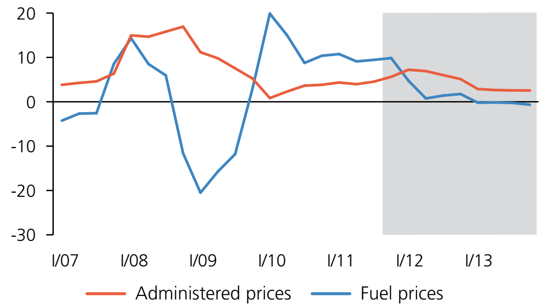


TABLE II.2.1

FORECAST OF ADMINISTRATIVE EFFECTS

The growth of administered prices will be due mainly to rising energy prices and growth in regulated rents

(annual percentage changes as of year-end; contributions to headline inflation in percentage points)

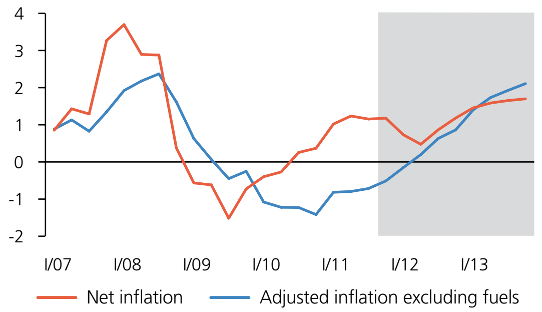
	2010 actual		2011 forecast		2012 forecast		2013 forecast	
Administered prices[a)]	3.8	0.66	6.1	1.06	4.7	0.86	2.5	0.47
of which (main changes):								
regulated rents	16.8	0.23	8.0	0.13	13.0	0.22	9.0	0.17
prices of electricity	-2.5	-0.09	4.8	0.17	6.0	0.21	-0.1	0.00
prices of natural gas	6.7	0.16	17.5	0.43	-1.0	-0.03	-4.1	-0.11
prices of heat	3.3	0.08	3.0	0.07	5.6	0.13	5.1	0.13
administered prices in healthcare	7.8	0.16	3.5	0.07	3.6	0.08	3.4	0.07
First-round impacts of tax changes in non-administered prices		1.02		0.00		0.95		-0.29

a) Including effects of indirect tax changes

Chart II.2.3

NET INFLATION AND ADJUSTED INFLATION EXCLUDING FUELS

Adjusted inflation excluding fuels will turn positive in 2012 Q2
(annual percentage changes)



In 2011 Q3, annual inflation was not affected by changes to **indirect taxes**. The forecast assumes an increase in the reduced VAT rate from 10% to 14% as of January 2012. The first-round effect of this change can be estimated at about 1.1 percentage point. January 2012 will also see a "harmonisation increase" in excise duties on cigarettes with a contribution to inflation of just above 0.1 percentage point. The forecast then expects the two VAT rates to be unified at 17.5% in January 2013, with an overall first-round effect on inflation of about -0.2 percentage point. The second-round effects of these changes on inflation expectations and wage growth are not expected to be significant.

Annual **net inflation** was 1.2% on average in 2011 Q3 (see Chart II.2.3). This was a result of the contrary effects of slowing growth in food prices and faster growth in fuel prices together with a shift of adjusted inflation excluding fuels to less negative figures. In 2011 Q4, net inflation will be roughly flat, with the annual decline in adjusted inflation excluding fuels continuing to slow and fuel prices accelerating slightly, whereas food price inflation will decrease. The forecast expects net inflation to fall to 0.5% in 2012 H1 as a result of an expected annual decline in prices of energy and food commodities on world markets, which will pass through significantly to slowing food and fuel price inflation. Once this effect subsides, net inflation will increase as a result of gradually rising domestic cost pressures to about 1.7% in 2013 H2. By contrast, renewed exchange rate appreciation will act against a more marked pick-up in net inflation.

Annual **adjusted inflation excluding fuels** shifted to less negative values in 2011 Q3 (see Chart II.2.3). These values still reflect weak domestic demand, which is constraining growth of sellers' margins in an environment of still subdued domestic cost pressures. The forecast expects adjusted inflation excluding fuels to move towards zero in 2011 Q4 and turn positive in 2012 Q2. This trend will reflect the currently inflationary effect of import prices and the expected future growth in domestic cost pressures. Their gradual strengthening, only partly offset by a renewed fall in import prices, will cause adjusted inflation excluding fuels to rise to 1.2% at the end of next year. Subsequently, adjusted inflation excluding fuels will increase to 1.6% in 2013 owing to the unwinding of the anti-inflationary effect of import prices and to still present inflationary pressures from the domestic economy. This will also be fostered by expected positive instant second-round effects stemming from the reduction of the basic VAT rate to 17.5% in January 2013, i.e. the incomplete pass-through of this tax change to prices.

Annual **food price inflation** decreased in 2011 Q3 as a result of a strong fall in agricultural producer price inflation and decelerating inflation in the food industry. The developments across the food categories were mixed. The slowdown in food price inflation was largely due to an unusually sharp fall in prices of vegetables and fruit. The forecast expects annual food price inflation to moderate further in 2011 Q4 owing to a more marked pass-through of the weakening growth in agricultural producer prices. At the beginning of next year, partial pass-through of the VAT rate increase to consumer prices also contributes to lower food price inflation excluding the first-round effects of tax changes. Food price inflation (excluding the first-round effects of tax changes) will thus approach 1% in 2012 Q1 and gradually recover thereafter (see Chart II.2.4). A near-term risk to the forecast is advance partial pass-through of the expected VAT change to some food prices, and a longer-term risk is the evolution of agricultural commodity prices internationally.

Fuel price growth increased year on year in 2011 Q3, with the weakening annual appreciation of the koruna against the dollar only partly offsetting higher world oil prices. The forecast expects slightly faster growth in fuel prices in the near term amid still high global oil prices and annual depreciation of the koruna-dollar rate. An expected decrease in oil prices and renewed appreciation of the koruna against the dollar will then foster a significant slowdown in fuel prices (see Chart II.2.5).

Czech money market **interest rates** were flat in 2011 Q3. Rates with maturities longer than one year decreased. Consistent with the forecast is a slight decline in market interest rates at the start of the forecast and flat rates until late 2012/early 2013 (see Chart II.2.6). The fall in 3M PRIBOR rates at the start of the forecast horizon is due mainly to a decline in foreign interest rates expected by the market and to low domestic demand. Interest rates do not react to the expected temporary rise in headline inflation above the target in 2012 caused by the first-round effects of the changes to indirect taxes, to which the escape clause mechanism applies as usual.

The koruna weakened slightly against the euro on average in 2011 Q3, but depreciated more markedly at the end of the quarter owing to the escalation of the euro area debt crisis. The forecast for 2011 Q4 assumes an average exchange rate of CZK 24.8 to the euro (see Chart II.2.7). In the forecast, however, this depreciation is considered to be a temporary shock caused by a short-term increase in the risk premium due to the European debt crisis, after which the exchange rate will correct rapidly. The subsequent exchange rate appreciation is due mainly to the low foreign interest rate level expected by the markets. This can be interpreted as the ECB returning to a crisis monetary policy regime, while the October CF forecast for external economic activity has been reduced considerably but still represents a short-term growth fluctuation rather than a new wave of crisis. As a result, the effect of the interest rate differential outweighs the worse outlook for external demand in the exchange rate forecast.[3] The gradual renewal of long-term real convergence will also foster appreciation of the koruna in the longer run.

3 The uncertainty associated with this foreign outlook combination is described in the alternative scenario of the forecast (see section II.4).

CHART II.2.4

FOOD PRICES AND AGRICULTURAL PRODUCER PRICES

Food price inflation will slow sharply as agricultural producer price inflation subsides
(annual percentage changes)

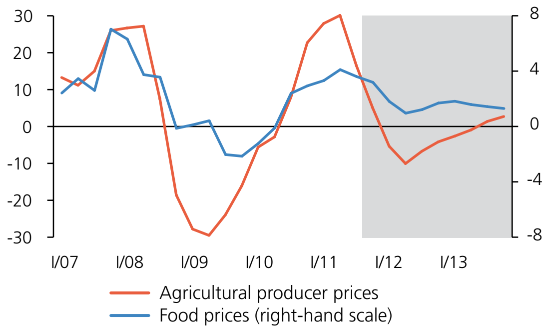


CHART II.2.5

FUEL PRICES AND OIL PRICES

The forecast expects fuel price inflation to slow in connection with a falling outlook for oil prices
(annual percentage changes)

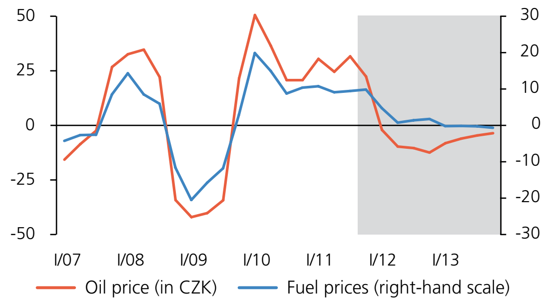


CHART II.2.6

INTEREST RATE FORECAST

Consistent with the forecast is a slight decline in market interest rates at the start of the forecast and flat rates until late 2012/early 2013
(3M PRIBOR and 3M EURIBOR in %)

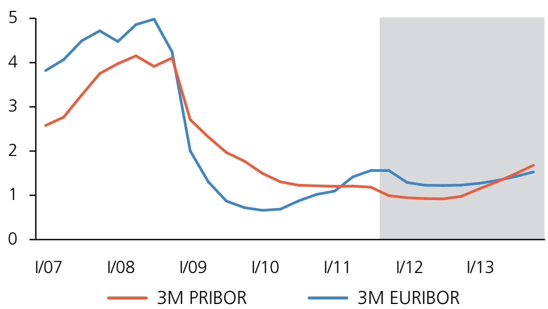


CHART II.2.7

EXCHANGE RATE FORECAST

After an initial depreciation, the nominal exchange rate of the koruna against the euro is appreciating over the forecast horizon
(CZK/EUR and CZK/USD)

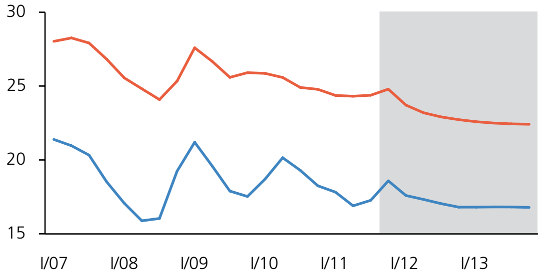


CHART II.2.8

COSTS IN THE CONSUMER SECTOR

Pressures from the domestic economy will grow steadily over the forecast horizon, while import prices will fall
(quarterly percentage changes; contributions in percentage points; annualised)

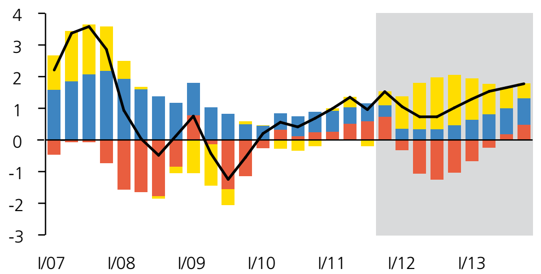
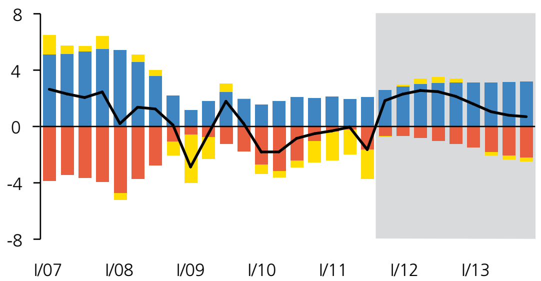


CHART II.2.9

COSTS IN THE INTERMEDIATE GOODS SECTOR

Gradually strengthening growth in wages will not be sufficiently offset by growth in labour productivity
(quarterly percentage changes; contributions in percentage points; annualised)



Quarterly growth in **nominal marginal costs in the consumer goods sector** was subdued in 2011 Q3 (see Chart II.2.8) Inflation pressures stemming from import prices increased slightly as the strong growth in world commodity prices recorded in 2011 H1 passed through to foreign producer prices with a lag. The increase in the positive contribution of import prices was also due to the depreciation of the koruna. Pressures from the domestic economy, approximated by intermediate goods price inflation, are still insignificant owing to weak domestic demand and subdued wage growth. The estimated evolution of export-specific technology is linked to the persisting difference in the evolution of prices of tradables and non-tradables (the Balassa-Samuelson effect), which is now contributing less markedly to inflation than in the past.

Cost-push pressures from the domestic economy will initially increase gradually at the forecast horizon, mainly because of a gradual pick-up in wage growth coupled with low labour productivity growth. In 2013, the pressures from the domestic economy will ease again. By contrast, import prices will be inflationary at the start of the forecast horizon, reflecting the short-term depreciation of the koruna. The gradual return of export-specific technology growth to its long-run level reflects the assumption of a gradual renewal of equilibrium appreciation. Together with the renewed appreciation of the koruna, import prices will gradually turn anti-inflationary, remaining so until mid-2013.

Nominal marginal costs in the intermediate goods sector have been falling for some time, and the decline intensified in 2011 Q3. This was due to subdued wage growth coupled with short-term growth in labour-augmenting technology, which approximately reflects growth in whole-economy labour productivity (see Chart II.2.9). The falling price of capital, capturing the economic slowdown and falling prices of investment goods, is also fostering lower costs. Domestic cost-push pressures will re-emerge at the forecast horizon amid gradually accelerating growth in business sector wages and a broadly neutral contribution of the price of capital. The reasons also include an expected slowdown in labour productivity growth linked with the onset of a phase of economic downturn, which is captured only by a weakly negative contribution of labour-augmenting technology to cost growth.

The gap in **profit mark-ups in the consumer goods sector** closed in 2011 Q3 despite the low observed net inflation levels (see Chart II.2.10), as the weak inflation in the consumption sector was outweighed by even more subdued cost growth in this sector. The expected short-term slowdown in market price inflation amid continuing moderate growth in costs will cause the gap in profit mark-ups to open into negative values in the near future. This gap will not close until early 2013, when growth in economic activity is expected to gain momentum.

Whole-economy **labour productivity** in 2011 H2 will reflect the continuing economic slowdown, rising by 1.6% on average for the year as a whole. Its annual growth rate will continue to decline gradually until 2012 Q1 and the average for the entire year will fall to 1.1%. Productivity growth will then start to rise again owing to stronger economic growth abroad and consequently also in the Czech Republic, reaching 2.5% in 2013.

Annual growth in nominal **wages in the business sector** increased in 2011 Q2 (to 2.9% when seasonally adjusted). The forecast expects annual growth in average nominal wages in the business sector to accelerate gradually over the entire forecast horizon. This reflects the fact that the slowdown in foreign and domestic economic activity is viewed as temporary and not dramatic in the baseline scenario of the forecast.[4] The average wage in the business sector will increase by 3.2% in 2011 as a whole and accelerate to 4.1% next year. In 2013, wages will rise by 4.7% (see Chart II.2.11).

As a result of the continuing consolidation of public budgets, the forecast expects an annual decline in the average **wage in the non-business sector** of 1.2% in 2011.[5] In 2012, the average wage in the non-business sector will rise by 2.2%. The return to growth will be due mainly to a smaller decrease in wages and salaries in organisational units of the state than in 2011. Wages in the non-business sector will also grow by around 2% in 2013.

Real GDP growth slowed considerably in 2011 Q2 compared to the previous quarter, to 2.2% year on year and 0.1% quarter on quarter (see Chart II.2.12). The slowdown in annual GDP growth was due chiefly to net exports and to a lesser extent to increased negative contributions of household and government consumption. By contrast, the positive contributions of fixed investment and inventories were higher than a quarter earlier.

The forecast expects annual **growth in economic activity** to slow further to 1.7% in 2011 Q3. The slowdown should be due mainly to change in inventories. The decline in government consumption should deepen and the contribution of household consumption will also stay slightly negative (see Chart II.2.13). Net exports will make a strong positive contribution amid a relatively sharp drop in imports due chiefly to a fall in import-intensive investment. Exports will meanwhile slow as a result of falling external demand. The forecast expects GDP growth of 2.0% for 2011 as a whole. This level is slightly lower than in 2010, mainly because of slowing investment in inventories and falling government consumption. As regards inventories, the slowdown is due to the unwinding of the effect of their replenishment following last year's external demand recovery. The fall in government consumption reflects fiscal austerity measures. Household consumption will

4 By contrast, the alternative scenario assumes a deeper economic downturn connected with significantly slower growth in nominal wages (see section II.4).
5 This decline will be accompanied by a decrease in employment, so that the total volume of wages and salaries in the non-business sector will fall by 3.4%.

CHART II.2.10

GAP IN PROFIT MARK-UPS IN THE CONSUMER SECTOR

The gap in profit mark-ups will open into negative values again at the start of the forecast
(percentages)

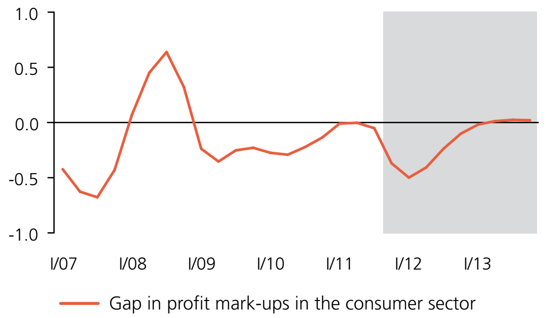


CHART II.2.11

AVERAGE NOMINAL WAGE

Wage growth in the business sector will gradually accelerate, while wages in the non-business sector will see renewed growth in 2012
(annual percentage changes; seasonally adjusted)

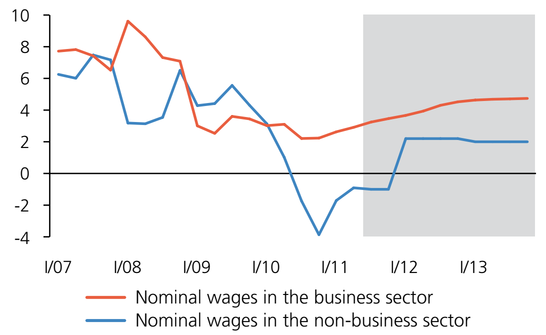


CHART II.2.12

GDP GROWTH FORECAST

GDP growth will slow significantly in the coming quarters
(percentage changes; seasonally adjusted)

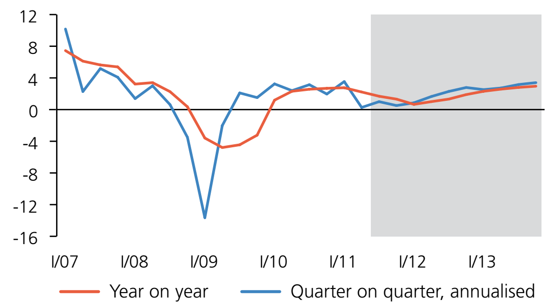


CHART II.2.13

ANNUAL GDP GROWTH STRUCTURE

The components of domestic demand will be the sole source of GDP growth in 2012, but they will be joined by net exports in 2013

(annual percentage changes; contributions in percentage points; seasonally adjusted)

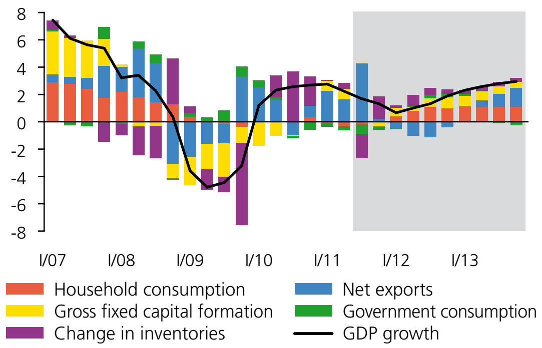


CHART II.2.14

LABOUR MARKET FORECAST

Total employment will rise at a very subdued rate

(annual percentage changes in employment; general unemployment rate in percentages; seasonally adjusted)

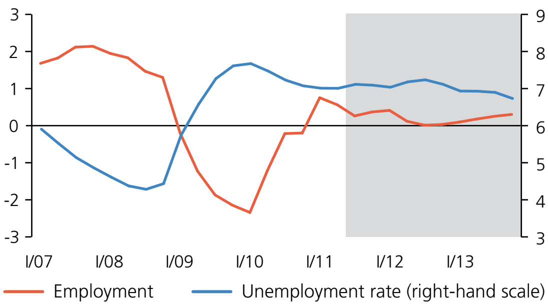
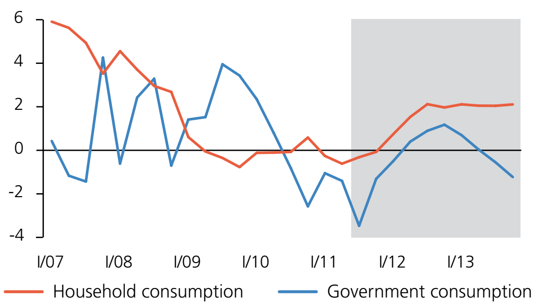


CHART II.2.15

REAL HOUSEHOLD AND GOVERNMENT CONSUMPTION

Household consumption will gradually recover over the forecast horizon

(annual percentage changes; seasonally adjusted)



edge down owing a weak recovery on the labour market and the consolidation of public budgets. The contributions of fixed investment and, above all, net exports will be positive for the year as a whole.

The forecast expects GDP growth to slow to 1.2% in 2012 owing chiefly to a more marked slowdown in exports than imports, reflecting weaker growth in external demand. The smallest year-on-year increase will occur in 2012 Q1.[6] All components of domestic demand will recover slightly. Despite the dampening effect of the increase in the reduced VAT rate, household consumption will record the strongest rise as a result of growth in wages and salaries. Real economic activity will rise by 2.7% in 2013 owing to renewed growth in the euro area and more moderate impacts of fiscal consolidation. Household consumption will rise further amid continuing moderately favourable labour market developments. Stronger growth in external demand will cause the contribution of net exports to turn positive again. As in 2012, investment will record positive contributions to growth, while the contributions of government consumption will be broadly neutral.

The fading economic recovery will be reflected on the labour market in a modest year-on-year rise in total **employment**, which will reach 0.5% in 2011 as a whole. Total employment will be broadly flat from 2012 Q2 onwards owing to the slowdown in economic activity. It will not return to growth until the second half of 2013 (see Chart II.2.14). Employment will increase on average by only 0.1% in 2012 and 0.2% in 2013.

As a result of the aforementioned developments, the seasonally adjusted **general unemployment rate** will be flat at 7.1% in the second half of 2011. It will also stay at this level on average next year, with the weak increase in employment being offset by a moderate rise in the labour force (see Chart II.2.14). The general unemployment rate will drop to 6.9% in 2013 as growth in economic activity accelerates. The seasonally adjusted **registered unemployment rate** will be flat at the end of this year. Next year it will edge down to 8.8%. Like the general unemployment rate, the registered unemployment rate will decline more significantly (to 8.2%) in 2013 owing to a recovery in economic activity.

Real **household consumption** will record slightly negative growth this year and will decline more moderately in H2 than at the start of the year (see Chart II.2.15). A stronger recovery in consumption is being prevented by subdued growth in nominal disposable income. This is closely linked with the current labour market situation and the government consolidation measures. Real consumption is also being dampened by higher inflation than in 2010. In 2012, consumption will record positive growth rates, rising by 1.6% for the year as a whole owing to growth in the volume of wages and the unwinding of the

6 The alternative scenario assumes a more marked slowdown in economic growth (see section II.4).

effect of government expenditure measures. The rise in the reduced VAT rate will act in the opposite direction. In 2013, the forecast expects consumption to accelerate to 2.1% as a result of gradually improving labour market conditions and a decline in headline inflation.

The nominal household consumption forecast is closely linked to the evolution of **gross disposable income**, the growth rate of which is rising gradually over the entire forecast horizon. This rise is due mostly to its largest component – the volume of wages and salaries (see Chart II.2.16). The rise in the volume of wages is due mainly to the average wage in the private sector. By contrast, the number of employees will decline slightly in year-on-year terms in 2012 H2 and early 2013; it will rise modestly in the rest of 2013. The contribution of social benefits should also be positive, owing to a rise in pension expenditure, which will outweigh the effect of austerity measures in the state social support area. The contributions of operating surplus and mixed income to disposable income, relating to the profits of small businesses, will be slightly positive from 2012. By contrast, current taxes and social benefits paid from the rising volume of wages and salaries will have a negative impact, especially in 2013, despite a fall in social security contributions resulting from the pension reform (see Box 1 below).

Consistent with the above evolution of nominal consumption and disposable income is a rise in the **saving rate** this year. In 2012, the saving rate will dip temporarily as a result of rising consumption expenditure following the increase in the reduced VAT rate. After the effect of the VAT change unwinds, the saving rate will begin to creep up in 2013 thanks to improving conditions on the labour market and to the pension reform. At the end of the forecast horizon it should stabilise around 10%, i.e. roughly 1 percentage point below its pre-crisis peak.

The impact of the government austerity measures on **government consumption** has been visible since 2010 H2. It will probably continue to fall until the start of next year. In 2012, fiscal consolidation will be focused more on boosting tax revenues, primarily through a rise in the VAT rate. However, government consumption growth will remain relatively weak (0.5% year on year). Further austerity measures are expected in 2013 in response to the fall in tax revenues stemming from subdued economic growth. This, in turn, will lead to a slight decrease in government consumption of 0.3%.

Gross capital formation recorded stronger annual growth (5.5%) in 2011 Q2, with both of its components making positive contributions. This result was due to base effects, as only fixed investment increased in quarter-on-quarter terms, while change in inventories declined. In 2011 H2, the forecast initially expects a decrease (due to a high comparison base for inventories), followed by a recovery in annual growth in gross capital formation (see Chart II.2.17). In the years ahead, gradual growth in both components of capital formation should continue. The contribution of fixed investment will be dominant given the expected recovery of external demand and the Czech economy

CHART II.2.16

NOMINAL DISPOSABLE INCOME

Gross disposable income will rise owing to a rising volume of wages and salaries
(annual percentage changes; contributions in percentage points)

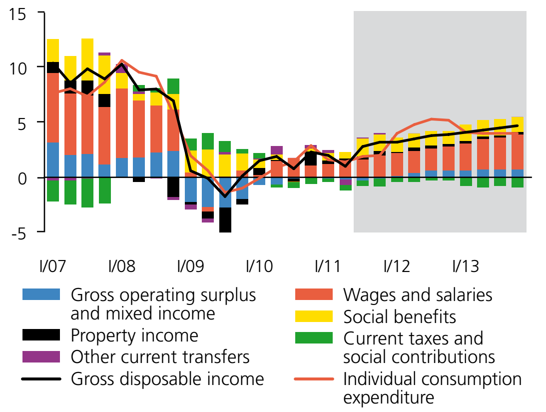


CHART II.2.17

GROSS CAPITAL FORMATION

The forecast expects gradual growth in both components of capital formation as from 2012
(annual percentage changes; seasonally adjusted)

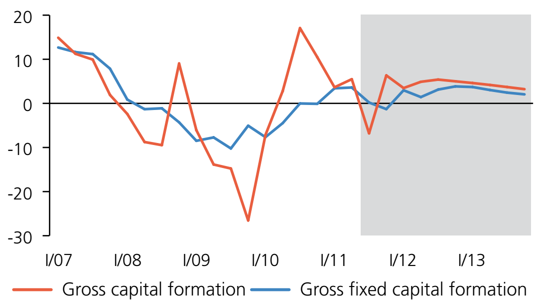
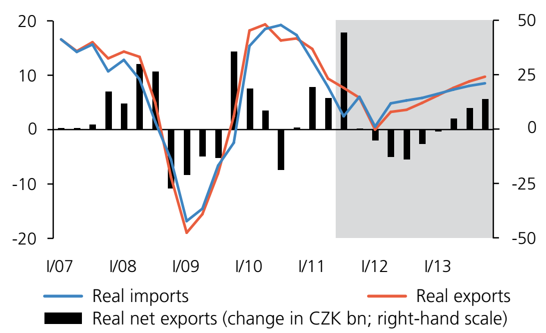


CHART II.2.18

REAL EXPORTS AND IMPORTS

The contribution of net exports will be negative in 2012 but turn positive in 2013; both export growth and import growth will slow significantly
(annual percentage changes; annual changes in CZK billions; seasonally adjusted)



after 2012. Gross capital formation will thus grow by 4.7% year on year in 2012. In 2013, the forecast expects investment growth to be close to its 4% long-term equilibrium level.

Real exports of goods and services slowed sharply in 2011 Q2 to a year-on-year growth rate of 9.4%, and even fell in quarter-on-quarter terms. This slowdown chiefly reflects weaker external demand, showing up as a sharp deceleration in foreign trade turnover. In the second half of this year and in early 2012, the forecast expects an annual slowdown and weak quarterly growth in exports in connection with a similar trend in external demand (see Chart II.2.18). Export growth will then start to rise gradually in response to a renewed recovery abroad, reaching almost 10% year on year at the end of 2013.

Given the slowdown in import-intensive exports and the drop in household consumption in 2011 Q2, **real imports** of goods and services also recorded a decline in growth (to 7.9%). The forecast expects annual import growth to slow to zero at the start of 2012. In the rest of 2012 and in 2013, imports will – like exports and most components of domestic demand – recover gradually.

Despite a larger decline in export growth than in import growth, **net exports** made a significant positive contribution to annual GDP growth in 2011 Q2 (1.6 percentage points). The forecast expects a significantly positive contribution of net exports to annual growth in 2011 Q3. However, this contribution should drop towards zero at the close of the year. Its volatility is due partly to base effects, but also to the evolution of gross capital formation, whose decline will reduce imports in 2011 Q3. In 2012, the contribution of net exports to annual GDP growth should be negative owing to a gradual recovery in most components of domestic demand amid a downswing in export growth. It will return to positive figures in 2013 thanks to a stronger increase in external demand and exports (0.7 percentage point).

The balance of payments forecast expects the **current account** deficit to edge up above the 2010 level in 2011 and 2012 and then return roughly to the 2010 level in 2013 (see Table II.2.3). In relative terms, this implies broad stability of the deficit slightly above 3% of GDP in 2011, an increase to about 3.6% in 2012 and a decline below 3% in 2013. The income balance will foster higher current account deficits over the entire forecast horizon, even though the rise in its deficit will slow as the economy cools. Fluctuations are visible in the trade balance forecast, which is significantly affected by forecasted changes in external and domestic demand and world commodity prices. The annual growth in the goods and services surplus in 2011 is linked mainly with a slowdown in import growth (due to fading imports for photovoltaic power stations) and flat aggregate domestic demand (due to restrictive fiscal policy) amid strong growth in external demand, especially in the first half of the year (see section III.6). In 2012, the goods and services surplus should fall slightly, owing chiefly to a slowdown in foreign economic activity and renewed growth in domestic demand. A relatively significant improvement in the goods

TABLE II.2.2

FORECAST OF SELECTED VARIABLES

The labour market recovery will remain insignificant
(annual percentage changes unless otherwise indicated)

	2010 actual	2011 forec.	2012 forec.	2013 forec.
Real gross disposable income of households	0.3	0.2	0.4	2.4
Total employment	-1.0	0.5	0.1	0.2
Unemployment rate (in per cent)[a)]	7.4	7.1	7.1	6.9
Labour productivity	3.2	1.6	1.1	2.5
Average nominal wage	1.9	2.4	3.8	4.2
Average nominal wage in business sector	2.5	3.2	4.1	4.7
Current account deficit (ratio to GDP in per cent)	-3.2	-3.2	-3.6	-2.8
M2	4.0	3.5	4.0	5.7

a) ILO methodology, 15–64 years

TABLE II.2.3

BALANCE OF PAYMENTS FORECAST

An increasing income deficit and a declining trade surplus will widen the current account deficit in 2012
(CZK billions)

	2010 actual	2011 forec.	2012 forec.	2013 forec.
A. CURRENT ACCOUNT	-116.4	-120.0	-140.0	-115.0
Trade balance	53.8	90.0	80.0	110.0
Balance of services	75.3	70.0	70.0	75.0
Income balance	-254.7	-280.0	-290.0	-300.0
Current transfers	9.2	0.0	0.0	0.0
B. CAPITAL ACCOUNT	32.4	18.0	18.0	18.0
C. FINANCIAL ACCOUNT	183.2	38.0	115.0	95.0
Direct investment	97.0	70.0	70.0	70.0
Portfolio investment	157.4	-15.0	40.0	25.0
Financial derivatives	-4.1			
Other investment[a)]	-68.2	-17.0	5.0	0.0
D. ERRORS AND OMISSIONS	-57.9			
E. CHANGE IN RESERVES (- = increase)	-41.4			

a) forecast excluding operations of banking sector and services balance in 2013 reflects an assumption of a year-on-year fall in prices of imported energy commodities and a rebound in external demand growth. The rising income deficit will be due mainly to growth in dividends paid on foreign direct investment in the Czech Republic and growth in the interest income deficit linked with faster growth in debt liabilities than in claims, which is connected partly with the financing of the current account deficit and partly with the fiscal deficit. Current transfers should remain roughly balanced, with public transfers generating a surplus that will be eliminated by a private transfers deficit.

The current account deficit will be financed by a capital account surplus (linked primarily with drawdown of EU funds and sales of emission permits by private entities) and a financial account surplus (due above all to a net inflow of direct investment and, in 2012 and 2013, also portfolio investment). Relatively significant involvement of the banking sector in financing the deficit is also visible in 2011. The net inflow of **direct investment** will decline slightly in the forecast period as compared to 2010 and will essentially correspond to the reinvested earnings figures only, owing to the considerable uncertainty surrounding future economic developments in Europe.[7] As regards **portfolio investment**, the inflow of about CZK 150 billion (in 2009 and 2010) switches abruptly to a slight deficit in 2011 owing to substitution of foreign financing of the general government deficit with domestic sources, a marked fall in the financing needs for the foreign expansion of ČEZ and renewed interest of residents in investing abroad. The forecast also expects the state's foreign financing needs to remain low in the years ahead. On the other hand, the forecast expects that, as in 2009, the financial flows on the asset side will change and domestic investors will use part of their foreign investments to finance domestic needs.

The future macroeconomic developments described above are reflected in the **government finance** outlook for 2011–2013 (see Table II.2.4). Like the previous forecast, the baseline scenario of the fiscal forecast works with the assumption of a rise in the reduced VAT rate from 10% to 14% in 2012 and unification of the two VAT rates at 17.5% in 2013. The forecast newly includes the effect of the pension reform planned to be launched in 2013.

The forecast expects the **general government deficit** to fall to 3.8% of GDP in 2011[8] owing to consolidation measures adopted in connection with the preparation of the 2011 state budget. The restrictive effect of these measures, dampening GDP growth this year by around 0.6 percentage point, enters the forecast mainly via government and

7 As regards investment in the Czech Republic, the forecast expects reinvestment amounting to about one-third of non-residents' total earnings on direct investment.

8 On 30 September, the CZSO sent Eurostat data on government finance in 2007–2010 under the ESA 95 methodology as part of the autumn government deficit and debt notifications. The general government deficit figures for the previous years were revised and the figure for 2010 was changed from -4.7% of GDP to -4.8% of GDP in this update.

Table II.2.4

FISCAL FORECAST

The fiscal consolidation will reduce the general government deficit in 2011 and 2012

(% of nominal GDP)

	2010 actual	2011 forec.	2012 forec.	2013 forec.
Government revenue	39.3	39.5	41.0	40.4
Government expenditure	44.1	43.3	44.4	43.8
of which: interest payments	1.4	1.4	1.5	1.6
GOVERNMENT BUDGET BALANCE	-4.8	-3.8	-3.4	-3.5
of which:				
primary balance[a)]	-3.4	-2.4	-1.9	-1.9
one-off measures[b)]	-0.1	-0.2	-0.1	-0.4
ADJUSTED BUDGET BALANCE[c)]	-4.7	-3.7	-3.3	-3.1
Cyclical component (ESCB method)[d)]	-0.6	-0.3	-0.5	-0.4
Structural balance (ESCB method)[d)]	-4.2	-3.4	-2.8	-2.7
Fiscal stance in p.p. (ESCB method)[e)]	2.0	0.8	0.6	0.1
Cyclical component (EC method)[d)]	-0.5	-0.3	-0.4	0.0
Structural balance (EC method)[d)]	-4.2	-3.3	-2.9	-3.1
Fiscal stance in p.p. (EC method)[e)]	1.2	0.9	0.5	-0.2
Government debt	37.6	40.2	42.3	43.5

a) government budget balance minus interest payments
b) impact of the pension reform included in 2013
c) adjusted for one-off measures; CNB estimate
d) CNB estimate
e) year-on-year change in structural balance (positive value indicates fiscal restriction, negative value fiscal expansion)

household consumption. The forecast newly incorporates current problems with the drawdown of EU funds, which are reflected in lower capital income and lower government investment.

The forecast for 2012 is affected mainly by the increase in the reduced VAT rate, which will boost tax revenues by around CZK 25 billion. However, the higher living costs of households connected with the VAT increase will be partly offset by a rise in the personal income tax discount for dependent children (estimated impact: CZK 3.4 billion) and an increase in pensions (CZK 5.8 billion). The resulting restrictive effect of fiscal policy enters the forecast mainly via household consumption, with an estimated impact on real GDP growth of around -0.3 percentage point. The "small" pension reform – which will take effect at the end of 2011 – has a neutral overall impact on the budget.[9] As regards other government revenue and expenditure items, the forecast is based on an assumption of unchanged fiscal policy compared to 2011. Overall, a decrease in the general government deficit to 3.4% of GDP is expected in 2012, due mainly to higher revenues stemming from the increase in the reduced VAT rate.

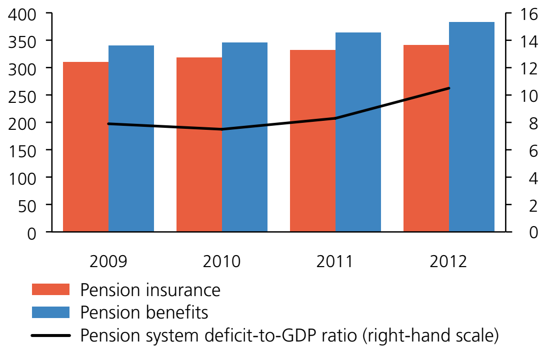
In 2013, the forecast assumes unification of the two VAT rates at 17.5%. This, however, will have a broadly neutral overall effect on tax revenues. At the same time, there will be a further (greater than usual) increase in pensions (an increase in pension expenditure growth of CZK 3.6 billion) due to higher headline inflation in 2012. The forecast incorporates the launch of the pension reform in 2013 (see Box 1), with a negative impact on social insurance collection of around CZK 15 billion. The real impacts on household consumption are likely to be negligible. The forecast for 2013 also expects additional spending cuts by the government aimed at reducing the negative impact of the expected slowdown in economic growth on the general government balance. These cuts will reduce GDP growth by just under 0.2 percentage point in 2013. Nevertheless, according to the forecast, the deficit-to-GDP ratio (3.5%) will exceed the planned level specified in the Convergence Programme (2.9%) The planned tax reform, including the taxation of gambling, has not yet made it far enough through the legislative process to be included in the forecast.

Chart 1 (Box)

PENSION SYSTEM DEFICIT

Growth in the pension system deficit-to-GDP ratio is beginning to accelerate

(CZK billions; share in % of GDP – right-hand scale; source: Ministry of Finance of the Czech Republic, CNB calculation)



BOX 1
PENSION SYSTEM REFORM

The pension reform, which will take effect in 2013, is a response to unfavourable demographic trends and the ensuing unsustainability of the current pension system (see Chart 1). At the same time, it introduces elements of diversification into the financing of the pension system. The existing pension

9 Under this "small" pension reform, the parameters of the pension system are being changed and the maximum annual assessment base for health insurance and social security contributions is being reduced from 72 to 48 times the average monthly wage.

system structure, based on a state-run pay-as-you-go (PAYG) system, with the option of taking out additional private pension insurance with pension funds, will be extended to include a new (second) "fund pillar". Entry into this pillar will be voluntary but irreversible. Persons under 35 years of age will be allowed to join the second pillar without restriction, while those aged over 35 will have to decide whether to join in the first half of 2013. Those who decide to join the second pillar will be allowed to transfer part of their pension insurance (3% of the assessment base) from the PAYG system (their state pension will be reduced proportionately), to which they will add a further 2% of their own funds. The newly established pension companies will offer four types of funds differing in terms of investment strategy.

It is not entirely clear from the current configuration of the new pension system whether the original objective of the pension reform, namely to enhance the sustainability of the PAYG pillar, will be achieved. The voluntary nature of the partial opt-out from the PAYG pillar means that the participants in the second pillar will probably come mostly from higher-income groups. This, in turn, will have a generally adverse impact on the long-term balance of the PAYG pillar (this effect will be reduced by the 2011 "small pension reform", consisting in parametric changes to the PAYG system).

The Czech Finance Ministry estimates in its medium-term outlook that up to 50% of policyholders will take advantage of the opportunity to join the second pillar in 2013. This will have a negative impact of around CZK 20–27 billion on revenues from social security contributions. By comparison with the Czech Ministry of Finance, the CNB forecast assumes lower take-up for the fund pillar and thus a lower impact on revenues from social security contributions of around CZK 15 billion. The forecast also assumes that the additional household expenditure related to participation in the second pillar will not have a major negative impact on household consumption, since the participants will mostly be persons with higher income, who can cover this additional expenditure by changing the structure of their savings. At the same time, the forecast assumes no increase in consumption as a result of the higher disposable income caused by the decline in social security contributions. Overall, therefore, the impact of the pension reform on household consumption is assumed to be neutral.

The general government **structural deficit** was around 4.2% of GDP in 2010 and will fall to significantly lower levels in 2011–2013. The expected general government deficit will lead to an increase in general government debt from 37.6% of GDP in 2010 to 43.5% of GDP in 2013.

Lower economic growth than expected by the baseline scenario of the forecast (see the alternative scenario in section II.4) represents a major **risk to the forecast** for 2012 and 2013; this would lead to a greater deviation of public budgets from the fiscal objectives. Any further austerity measures in the fiscal area in response to lower economic growth would foster a deeper cyclical downturn of the economy. The possible approval and implementation of the tax reform as originally planned, i.e. in 2013, is also a risk to the forecast. The tax reform should have a slightly stimulating impact on household consumption and the opposite effect on corporations and investment, its overall impact being slightly restrictive. The potential approval of the taxation of gambling would foster a rise in fiscal revenues (of around CZK 8 million).

II.3 COMPARISON WITH THE PREVIOUS FORECAST

The predictions for headline and monetary-policy relevant inflation are lower than in the previous forecast because of their lower initial levels and the currently more subdued pressures from the domestic economy and also in response to the less favourable outlook for external demand. The significantly lower outlook for foreign interest rates is acting on domestic interest rates in the same direction; however, this effect is partly dampened by the currently weaker exchange rate. Following a short-lived depreciation, the exchange rate forecast quickly returns to the levels observed in the previous forecast and also fosters lower inflation. The annual GDP growth rate will be significantly lower over the next two years. This is due mainly to a lower outlook for growth in the effective euro area and to new data on domestic economic activity for 2011 Q2. The expected pace of wage growth in the business sector has also been revised downwards.

The forecast for annual **headline inflation** is lower than the previous forecast (see Chart II.3.1). This is due to lower growth in administered prices and net inflation. The assumptions about the impacts of changes to indirect taxes are unchanged, so **monetary-policy relevant inflation**, i.e. inflation adjusted for the first-round effects of changes to indirect taxes, is also lower and will be slightly above the 2% inflation target.

Expected **administered price inflation** is slightly higher this year because of a greater increase in prices of natural gas for households together with an expected jump in rail fares and prices of postal services. On the other hand, the outlook for growth in regulated rents has been reduced over the entire horizon in a context of expected weaker economic activity. Administered price inflation will be newly affected in 2012 by an expected increase in the price of one-year motorway tax stickers and a larger rise in electricity prices. The evolution of administered prices of gas has been revised towards an annual decline in 2012 and 2013, owing to a lower outlook for prices of natural gas on world markets. Overall, the forecast thus expects slightly weaker growth in administered prices in both years.

Net inflation is lower over the entire forecast horizon than in the previous forecast (see Chart II.3.2). This change is initially due to lower observed values of all its components in 2011 Q3. A greater effect of the renewed appreciation of the exchange rate, faster dissipation of the growth in commodity prices and more subdued economic activity and wage growth are expected during 2012. Net inflation is lower in 2013 as a result of a slower recovery in external demand and lower government consumption.

All the variables of the **external environment outlook** have been revised. The 3M EURIBOR path has dropped significantly over the entire forecast horizon in response to the continuing euro area debt crisis (see section II.1). Lower growth rates of external demand are expected than in the previous forecast. The growth rates of foreign

CHART II.3.1

CHANGE IN THE HEADLINE INFLATION FORECAST

The outlook for administered price inflation and the forecast for net inflation have shifted the headline inflation forecast downwards

(annual percentage changes; differences in percentage points – right-hand scale)

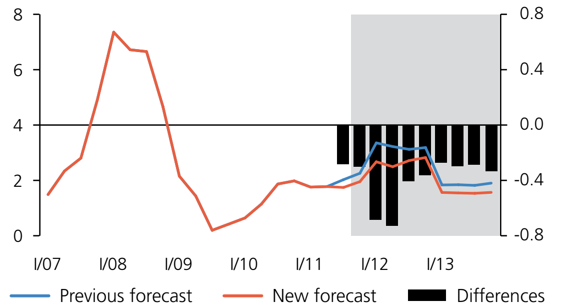


CHART II.3.2

CHANGE IN THE NET INFLATION FORECAST

The reduction in the net inflation forecast in 2012 is due mainly to developments abroad

(annual percentage changes; differences in percentage points – right-hand scale)

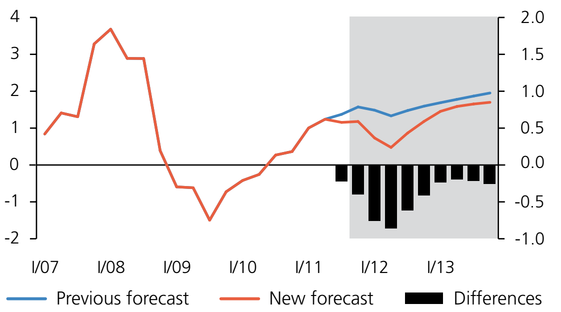


CHART II.3.3

CHANGE IN THE INTEREST RATE PATH

The forecast for market interest rates has moved to a significantly lower level

(in %; differences in percentage points – right-hand scale)

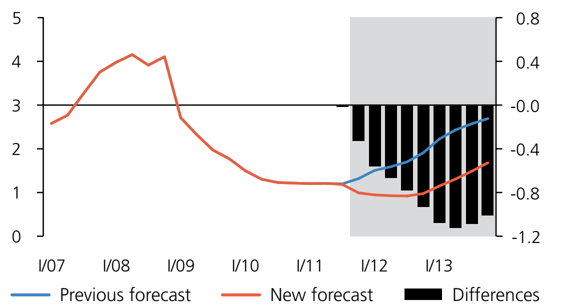


CHART II.3.4

DECOMPOSITION OF CHANGES IN THE INTEREST RATE FORECAST

A lower outlook for foreign interest rates is contributing significantly to lower interest rates, while the short-run evolution of the exchange rate is acting in the opposite direction

(3M PRIBOR; percentage points)

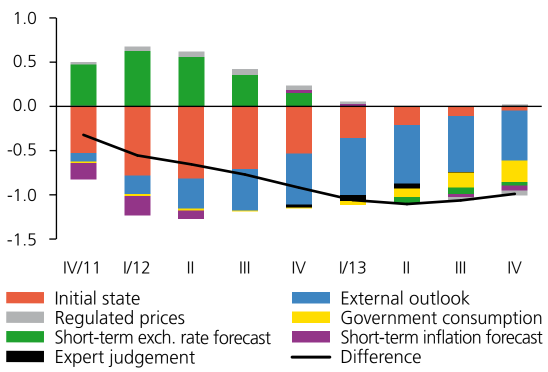


CHART II.3.5

CHANGE IN THE EXCHANGE RATE FORECAST

The exchange rate is substantially weaker at the start of the forecast

(CZK/EUR; differences in CZK – right-hand scale)

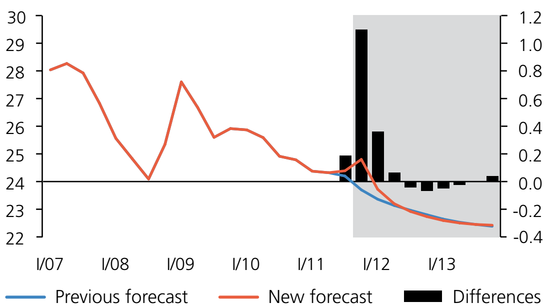
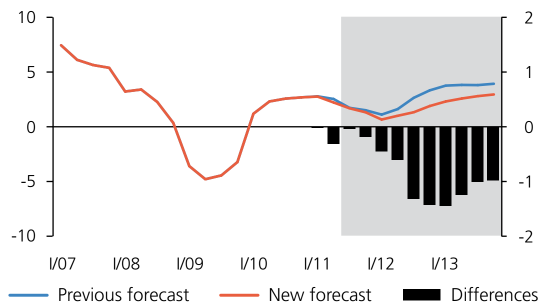


CHART II.3.6

CHANGE IN THE GDP FORECAST

The forecast for annual GDP growth has been reduced over the entire horizon

(annual percentage changes; differences in percentage points – right-hand scale; seasonally adjusted)



producer prices are higher at the start of the forecast due to the unwinding of the commodity price growth observed in 2011 H1. The outlook for foreign producer price inflation for the following years is little changed.

The forecast for domestic market **interest rates** is lower over its entire horizon, with the difference growing to more than 1 percentage point in the longer term (see Chart II.3.3). The lower rates at the start of the forecast are due to a lower short-term prediction for wage growth and observed net inflation in 2011 Q3. A negative contribution of the external environment due to the revised outlook for foreign interest rates is the biggest contributor to this change in the longer term. The short-term prediction for the exchange rate for 2011 Q4 is the only major factor fostering higher rates (see Chart II.3.4). The impacts of other factors on the change in the market interest rate forecast are not significant.

The prediction of the nominal **koruna-euro exchange rate** expects a depreciation at the start of the forecast horizon, reflecting increased uncertainty regarding the euro area debt crisis. However, the exchange rate returns to the stronger levels of the previous forecast in subsequent quarters (see Chart II.3.5). This is fostered by a significant decline in the outlook for foreign rates and a relatively slight decline in external demand.

The forecast for annual **GDP** growth has been reduced only slightly in 2011, but there is a significant downward revision for 2012 (see Chart II.3.6). This change is due mainly to a lower outlook for euro area demand and new data on GDP in 2011 Q2 (including a revision of the Q1 data).

The new forecast expects lower growth in **household consumption**, mainly because of lower predicted wage growth and slightly lower growth in employment.

The expected downturn in external demand exerts downward pressure on the forecast for **gross capital formation**, but a revision of the historical data has the opposite effect, so the overall prediction is little changed.

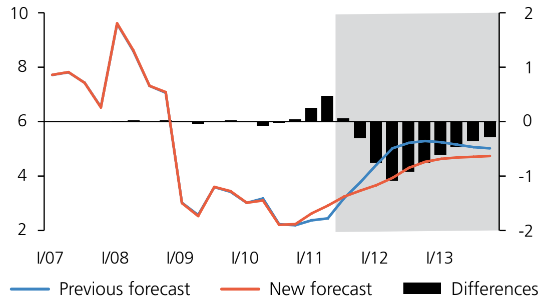
Newly published data on the growth rates of **exports and imports** indicate a decline in their volumes. At the same time, the external outlook has deteriorated, resulting in a decline in the forecast for total foreign trade turnover. The contribution of net exports to GDP growth is also considerably lower in 2012.

The forecast for average **nominal wage growth** in the business sector has decreased compared to the previous forecast in response to subdued leading indicators of wage growth for 2011 Q3 and a larger expected slowdown in economic activity connected with the euro area debt crisis (see Chart II.3.7).

CHART II.3.7

CHANGE IN THE NOMINAL WAGE FORECAST

The business-sector nominal wage forecast has decreased
(annual percentage changes; differences in percentage points – right-hand scale; seasonally adjusted)



II.4 ALTERNATIVE SCENARIOS AND SENSITIVITY ANALYSES

The risk of a deterioration in the external economic situation linked with the escalating euro area debt crisis was identified in the forecasting process. This risk seems to have been taken into account in the market outlook for foreign interest rates used in the baseline scenario of the forecast, but not in the outlooks of the October Consensus Forecasts. This has led to the preparation of an alternative scenario with an unchanged outlook for euro area rates but with a deeper downturn in external demand and inflation than in the baseline scenario. The alternative scenario results in a more significant cooling of domestic economic activity and a weaker exchange rate of the koruna, to which monetary policy responds with higher interest rates than in the baseline scenario. Headline domestic inflation is little changed. An exchange rate sensitivity scenario was also prepared as usual.

II.4.1 Alternative scenario – euro area stagnation

The preparation of the alternative scenario was motivated by concerns that the outlooks for external economic activity and interest rates may be mutually inconsistent. Analysts are incorporating the dramatic developments associated with the escalation of the global debt crisis only gradually into their expectations of economic activity and inflation, whereas the market outlook for interest rates has been responding strongly and immediately.[10] Therefore, an alternative outlook for foreign variables has been simulated using the NiGEM model.[11] According to this model, the alternative outlook corresponds to the current market outlook for euro interest rates.

This alternative outlook describes a marked **GDP growth slowdown in the euro area** in 2012 to almost zero on average. It is based on the assumption that the slowdown in economic activity compared to the baseline scenario occurs mainly as a result of stronger fiscal restriction, greater risk aversion and lower lending growth in individual member states, with a dampening effect on household consumption and investment. Growth in economic activity in export-oriented economies (e.g. Germany) will also be hindered by slower growth in net exports. A weaker exchange rate of the euro against the dollar in 2011 H2 is reflected in slightly higher growth in consumer and producer prices. However, the subdued economic activity will foster a sharp slowdown in those prices as from the start of 2012. The outlook for the Brent crude oil price responds to the fall in demand from the euro area countries by declining slightly. In these circumstances,

TABLE II.4.1

ALTERNATIVE SCENARIO – EXTERNAL VARIABLES

The current market outlook for 3M EURIBOR interest rates is consistent with a significant cooling of external economic activity

(deviations from baseline scenario)

	External PPI inflation (in p.p.)	3M EURIBOR (in p.p.)	Effective GDP (in p.p.)	Exchange rate USD/EUR (in %)
III/11	0.2	0.0	-0.3	0.0
IV/11	0.1	0.0	-0.5	-2.0
I/12	-0.1	0.0	-1.1	-2.0
II/12	-0.3	0.0	-1.4	-2.1
III/12	-0.5	0.0	-1.4	-2.1
IV/12	-0.6	0.0	-1.1	-2.1
I/13	-0.7	0.0	-0.4	-2.0
II/13	-0.7	0.0	-0.3	-1.8
III/13	-0.7	0.0	0.0	-1.7
IV/13	-0.8	0.0	0.0	-1.5

10 We refer to the experience of 2008 after the collapse of Lehman Brothers, when the CF outlooks lagged behind the sharp fall of the global economy into recession.

11 NiGEM is a global multi-country model enabling us to simulate the complete response of foreign variables to exogenous and endogenous shocks.

the ECB's response in the NiGEM model corresponds to the current market outlook for interest rates. The simulation results are shown in Table II.4.1 in the form of deviations from the assumptions of the baseline scenario of the forecast.

The change in effective external demand transmits immediately to the **domestic economy**. The fall in external demand relative to the baseline scenario has a negative impact on all components of GDP (except government expenditure). Owing to slower wage growth and adverse labour market developments, primarily reflecting the significantly lower external demand, household consumption is lower than forecasted. Growth in gross capital formation also falls in expectation of the onset of a phase of substantially lower economic activity. The fall in export growth compared to the forecast is a response to the fall in external demand, but is dampened by a substantially weaker outlook for the koruna exchange rate, which improves the price competitiveness of exporters. Imports for household consumption and investment activity decline sharply compared to the baseline scenario, moderating the fall in GDP. A more pronounced depreciation of the exchange rate is prevented by domestic monetary policy, which is reflected in a higher 3M PRIBOR compared to the baseline scenario. The more subdued economic activity and slower wage growth together with a lower outlook for prices of energy commodities have a downward effect on inflation, while the weaker exchange rate has the opposite effect. Overall, the deviations of headline inflation from the baseline scenario are therefore negligible. Table II.4.2 sums up the results of the simulation of the impacts on the domestic economy, also expressed as deviations from the baseline scenario of the forecast.

TABLE II.4.2

ALTERNATIVE SCENARIO – THE DOMESTIC ECONOMY

The lower external demand is strongly reflected in domestic GDP and wages; the exchange rate weakens despite higher domestic interest rates

(deviations from baseline scenario)

	CPI inflation (in p.p.)	3M PRIBOR (in p.p.)	GDP (in p.p.)	Nominal exchange rate (CZK/EUR)	Nominal wage (in p.p.)
IV/11	0.0	0.1	-0.4	0.0	-0.2
I/12	-0.1	0.3	-1.4	0.7	-0.6
II/12	-0.1	0.4	-1.7	1.0	-1.0
III/12	0.0	0.4	-1.9	1.2	-1.4
IV/12	0.0	0.4	-1.4	1.3	-1.5
I/13	0.1	0.2	-0.4	1.4	-1.3
II/13	0.0	0.1	-0.4	1.4	-1.1
III/13	0.0	-0.1	-0.1	1.4	-0.7
IV/13	0.0	-0.2	-0.3	1.5	-0.4

II.4.2 Exchange rate sensitivity scenario

This sensitivity scenario quantifies the impacts of a **different exchange rate path** compared to the forecast. This standard sensitivity scenario assumes a deviation of the nominal exchange rate of ±3% from the baseline scenario in the first quarter of the forecast. Interest rates in the first quarter of the forecast are the same as in the baseline scenario. The exchange rate is thus CZK 24.1/25.5 to the euro in 2011 Q4, compared to CZK 24.8 in the baseline scenario.

The table shows the results of the depreciation scenario, expressed as deviations from the baseline scenario of the forecast (see Table II.4.3). The scenario of a stronger nominal exchange rate leads to the same results but with the opposite sign.

Exchange rate depreciation improves producers' price competitiveness and, via higher net exports, leads to higher GDP growth compared to the baseline at the start of the forecast horizon. It also results in higher import prices and stronger inflation pressures. The market interest rate path is therefore higher than in the baseline scenario. However, GDP growth then slows slightly in response to tighter monetary policy and an exchange rate correction and returns to the baseline scenario at the end of the forecast horizon.

TABLE II.4.3

EXCHANGE RATE SENSITIVITY SCENARIO

Exchange rate depreciation leads to temporarily higher inflation and faster GDP growth than in the baseline scenario; interest rates increase

(deviations from baseline scenario)

	CPI inflation (in p.p.)	3M PRIBOR (in p.p.)	GDP (in p.p.)	Nominal exchange rate (CZK/EUR)
IV/11	0.0	0.0	0.2	0.7
I/12	0.0	0.3	0.2	0.3
II/12	0.1	0.3	0.2	0.1
III/12	0.2	0.3	0.1	0.0
IV/12	0.2	0.1	-0.2	0.0
I/13	0.1	0.0	-0.3	0.0
II/13	0.1	0.0	-0.2	0.1
III/13	0.0	0.0	-0.1	0.1
IV/13	0.0	0.0	0.0	0.0

Table II.5.1

EXPECTED INDICATORS OF FMIE AND CORPORATIONS

Inflation expectations are above the CNB's target
(at 1Y; annual percentage changes unless otherwise indicated)

	6/11	7/11	8/11	9/11	10/11
FMIE:					
CPI	2.7	2.7	2.8	2.8	2.8
CPI, 3Y horizon	2.5	2.4	2.3	2.3	2.2
Real GDP in 2011	2.1	2.1	2.1	2.0	1.9
Real GDP in 2012	2.8	2.7	2.2	1.6	1.3
Nominal wages in 2011	2.3	2.3	2.3	2.4	2.3
Nominal wages in 2012	4.2	4.2	3.6	3.4	3.1
CZK/EUR exchange rate (level)	23.7	23.7	23.8	23.7	24.0
2W repo rate (in per cent)	1.6	1.6	1.4	0.9	0.8
1Y PRIBOR (in per cent)	2.5	2.4	2.3	2.0	1.9
Corporations:					
CPI	2.5			2.4	

Chart II.5.1

PERCEIVED AND EXPECTED INFLATION

The inflation expectations of households decreased slightly in 2011 Q3
(source: European Commission Business and Consumer Survey)

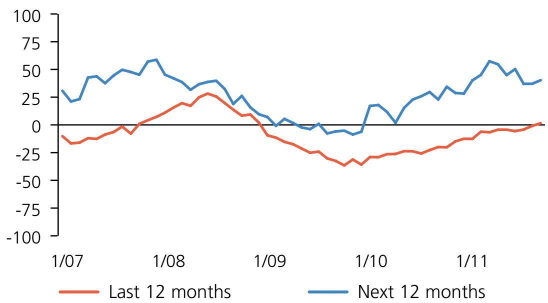


Table II.5.2

CF EXPECTED INDICATORS

The CF analysts expect economic growth to slow
(at 1Y; annual percentage changes unless otherwise indicated)

	6/11	7/11	8/11	9/11	10/11
Real GDP in 2011	2.3	2.3	2.3	2.1	2.0
Real GDP in 2012	2.9	2.7	2.5	1.8	1.5
Nominal wages in 2011	2.7	2.6	2.6	2.4	2.4
Nominal wages in 2012	4.5	4.6	4.3	3.7	3.4
CZK/EUR exchange rate (level)	23.8	23.8	23.9	23.9	24.0
3M PRIBOR (in per cent)	1.9	1.9	1.7	1.5	1.3

II.5 FORECASTS BY OTHER ENTITIES

Analysts' inflation expectations increased slightly in 2011 Q3 at the one-year horizon but declined at the three-year horizon. They are above the inflation target of 2% at both horizons. The analysts expect GDP growth to be about 2% this year and to slow next year. The majority of them also expect the koruna to appreciate and the CNB's key rates to be flat in the following 12 months. All the analysts were expecting stable key rates before the CNB Bank Board meeting in November. The market outlook for interest rates is gently falling, but is slightly above the baseline scenario of the CNB forecast.

Inflation expected by financial market analysts[12] at the one-year horizon edged up during Q3. By contrast, business managers reduced their prediction slightly. The expectations of both groups of respondents thus remained above the CNB's target of 2% (see Table II.5.1). Until recently, analysts' inflation expectations for the three-year horizon were about 0.5 percentage point above the CNB's target, but in the second half of this year they started to decline towards the 2% level.

The indicator of **inflation perceived by households** has long been rising gradually, and at the end of 2011 Q3 it was fluctuating around zero (see Chart II.5.1).[13] This means that households on average felt that prices rose only moderately over the last 12 months. The indicator of expected inflation increased quite considerably in early 2011 but has since been declining modestly for the most part. Positive values of this indicator suggest that the number of respondents who expect prices to rise more rapidly over the next 12 months is higher than the number of those who expect prices to stay the same or increase more slowly than in the past.

Both the FMIE and CF analysts expect GDP to grow by roughly 2% this year (see Tables II.5.1 and II.5.2). Economic growth is expected to slow next year, while wage growth is expected to pick up pace. Compared to the average koruna exchange rate in October 2011, the analysts participating in both the FMIE and the CF expect the exchange rate to be stronger at the one-year horizon (by around 3%). Before the November meeting of the CNB Bank Board, all twelve FMIE analysts were expecting no changes in key rates at this meeting. Most of the analysts expect rates to remain flat at the current level at the one-year horizon. Their estimates for the repo rate lie in the range of 0.75% to 1.00%. The forecasts for interest rates (including market ones) have thus changed considerably in recent months.

12 The CNB monitors the expectations of financial market analysts regarding key macroeconomic indicators and the inflation expectations of business managers by means of statistical surveys. Table II.5.1 shows average values from these surveys.
13 The CNB draws on the qualitative assessment of past and future inflation by households collected as part of the European Commission Business and Consumer Survey (see Box 2 in the July 2007 Inflation Report).

The expectations of rate increases were initially being shifted to the more distant future, but expectations of long-term stability of the CNB's key rates now prevail (for some analysts until the end of 2012).

Compared to the baseline scenario of the new CNB forecast, the analysts expect roughly the same rate of real GDP growth this year. Their predictions for next year are slightly higher. Inflation expected at the one-year horizon is at the same level as the CNB forecast. The exchange rate prediction at the one-year horizon is quite significantly weaker than the CNB's scenario (5.4% weaker). The analysts' expectations regarding the 2W repo rate and market rates at the one-year horizon are slightly above the 3M PRIBOR path consistent with the CNB forecast.

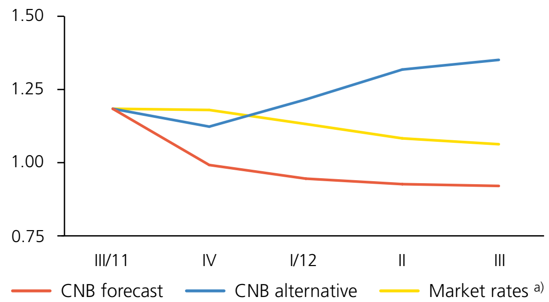
Compared to the alternative scenario of the new CNB forecast, the analysts expect roughly the same rate of real GDP growth this year. Their predictions for next year are significantly higher. Inflation expected at the one-year horizon is at the same level as the CNB forecast. The exchange rate prediction at the one-year horizon is the same as the CNB forecast. The analysts expectations regarding the 2W repo rate and market rates at the one-year horizon are broadly in line with the 3M PRIBOR path consistent with the alternative scenario of the CNB forecast.

Chart II.5.2 provides a **comparison of expected 3M market rates** derived from FRA quotations and the interest rate path consistent with the baseline and alternative scenarios of the new CNB forecast. The market path for 2012 is slightly higher than the baseline scenario but lower than the alternative scenario.

CHART II.5.2

FRA RATES VERSUS THE CNB FORECAST

The outlook for FRA rates for 2012 lies between the rates forecasted in the CNB's baseline and alternative scenarios
(percentages)



a) for 2011 Q3 and 2011 Q4 the 3M PRIBOR and for 2012 Q1–2012 Q3 the average values of the FRA 3*6, 6*9 and 9*12 rates for the last 10 trading days as of 21 October 2011

III. CURRENT ECONOMIC DEVELOPMENTS

III.1 INFLATION

Headline and monetary-policy relevant inflation both stood at 1.8% in September 2011 and were thus slightly below the CNB target. Annual administered price inflation rose slightly compared to the previous quarter. Market price inflation, as measured by net inflation, remained low in 2011 Q3 amid gradually fading pressures from commodity prices. Persisting weak domestic demand, low wage growth and mostly falling import prices of final products for the consumer market also had a dampening effect on net inflation.

III.1.1 Fulfilment of the inflation target

Headline inflation was slightly below the CNB's inflation target in 2011 Q3 (see Chart III.1.1). This section of the Inflation Report briefly analyses the contribution of the CNB's monetary policy to this situation.

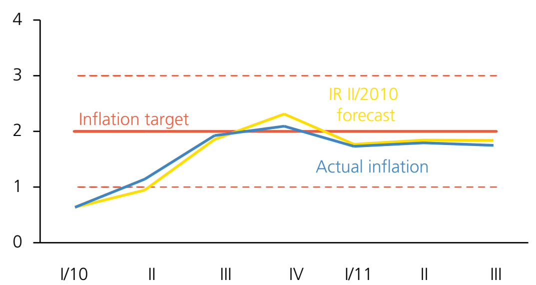
In order to assess the effect of monetary policy on the fulfilment of the inflation target one needs **to analyse retrospectively the forecasts** and the Bank Board's decisions based thereon in the past. To assess the fulfilment of the inflation target in 2011 Q3, we have to examine above all the period roughly from January 2010 to September 2010 (referred to as the "key period"), as monetary policy is focused on hitting the inflation target at the 12–18 month horizon. For the sake of clarity, the analysis of the accuracy of the forecasts is limited here to a comparison of the Inflation Report II/2010 forecast with subsequent inflation.

CHART III.1.1

FORECAST VERSUS ACTUAL INFLATION

Inflation was almost identical to the IR II/2010 forecast in 2011 Q3

(annual percentage changes)



The **Inflation Report II/2010 forecast** expected headline inflation to rise gradually. The low inflation at the start of the forecast horizon had been due mostly to a downturn in real economic activity; as a result, there had been no apparent inflationary pressures from the domestic economy or from import prices. Owing to the forecasted effect of changes to indirect taxes, inflation was expected to switch temporarily above the 2% inflation target at the end of 2010 and be slightly below the target as from the start of 2011 (see Chart III.1.1) thanks to a modest increase in economic activity supported by easy monetary policy over the entire forecast horizon.

TABLE III.1.1

FULFILMENT OF THE INFLATION FORECAST

Adjusted inflation excluding fuels fostered significantly lower inflation, while the contributions of other components were higher than forecasted

(annual percentage changes; contributions in percentage points)

	IR II/2010 forecast	2011 Q3 outturn	Contribution to total difference[b]
CONSUMER PRICES	1.8	1.7	-0.1
Breakdown into contributions:			
administered prices	2.8	4.5	0.3
first-round impacts of changes to indirect taxes	0.0	0.0	0.0
food prices[a]	1.3	3.6	0.6
fuel prices[a]	3.0	9.5	0.3
adjusted inflation excl. fuels[a]	1.7	-0.7	-1.2

a) excluding the first-round impacts of changes to indirect taxes
b) owing to rounding, the sum of the contributions need not be equal to the total difference

Headline **inflation in reality** was close to the forecasted values over the entire forecast horizon. However, the individual consumer price categories showed deviations in both directions. Adjusted inflation excluding fuels, which unexpectedly remained negative, was strongly anti-inflationary. It reflected low domestic inflation pressures and later also a stronger koruna. This negative deviation from the forecast was partly offset by higher administered prices (regulated rents and energy prices), food prices (an unexpectedly strong rise in agricultural producer prices) and fuel prices (world oil prices). The prediction of zero impacts of changes to indirect taxes was fulfilled (see Table III.1.1).

External economic factors contributed significantly to domestic inflation. The recovery in external – and therefore also domestic – economic activity was stronger than forecasted. At the same time, production prices abroad rose more quickly than forecasted. They were later followed by rising world prices of oil. These factors together fostered higher domestic inflation. By contrast, foreign interest rates were slightly lower than forecasted over almost the entire forecast horizon (see Table III.1.2).

Domestic **interest rates and the exchange rate** also differed from the forecast. The initially slightly tighter real interest rates – despite the lowering of monetary policy rates in May 2010 – gradually turned easier, mainly reflecting a lower interest rate path in the euro area than assumed in the forecast. The exchange rate was weaker than forecasted until mid-2010. Subsequently, however, the koruna quickly appreciated in response to improving export performance and a positive rating outlook for the Czech Republic amid still low foreign interest rates (see Table III.1.3).

Based on the CNB's current knowledge of the workings of the Czech economy and its current knowledge of the actual economic situation, the **developments since the forecast under review was drawn up** can be summed up in the following way. The stronger domestic economic growth was driven – via exports – by a faster recovery of external demand. At the same time, the appreciating koruna offset the impacts of the faster growth and higher external inflation on domestic inflation. The faster GDP growth was also due to stronger growth in gross capital formation caused by replenishment of inventories and higher household consumption. Wage growth was more subdued than forecasted. Owing to the above factors, headline inflation was slightly below the target in 2011 Q3. The low domestic interest rates reflected, in addition to subdued domestic inflationary pressures, continuing easy global monetary policy.

In addition to the forecast, an assessment of the risks associated with this forecast is important for the Bank Board's decisions on **monetary policy rates**. At its meetings between January 2010 and September 2010 the Bank Board assessed the risks of the forecasts initially as being balanced or slightly on the downside, in 2010 Q2 as being balanced, and in 2010 Q3 as being slightly on the downside or balanced. Despite the fact that the Bank Board regarded the risks as being on the downside, market interest rates were somewhat higher than implied by the forecasts in the first three quarters of 2010. Both headline and monetary-policy relevant inflation have recently been fluctuating close to the 2% target and their forecasts have been fulfilled almost completely. From this perspective, based on current knowledge, it seems that the monetary policy pursued in the first three quarters of 2010 was appropriate.

TABLE III.1.2

FULFILMENT OF THE EXTERNAL ASSUMPTIONS

External cost factors fostered higher inflation

(annual percentage changes unless otherwise indicated)

		II/10	III/10	IV/10	I/11	II/11	III/11
GDP in euro area[a), b), c)]	p	1.9	1.3	0.8	1.3	1.8	2.2
	o	3.0	3.1	3.1	3.6	2.8	-
PPI in euro area [b), c)]	p	0.6	1.9	2.1	2.0	1.9	2.0
	o	2.6	3.9	4.8	6.5	6.4	5.8
3M EURIBOR	p	0.7	0.9	1.2	1.3	1.5	1.7
(percentages)	o	0.7	0.9	1.0	1.1	1.4	1.6
USD/EUR exchange rate (levels)	p	1.34	1.34	1.34	1.33	1.33	1.33
	o	1.27	1.29	1.36	1.37	1.44	1.41
Brent crude oil price	p	84.8	87.0	88.3	89.2	89.9	90.5
(USD/barrel)	o	78.6	76.4	86.9	105.2	116.8	112.4

p – prediction, o – outturn
a) at constant prices
b) seasonally adjusted
c) effective indicator as defined in the IR II/2010 forecast

TABLE III.1.3

FULFILMENT OF THE FORECAST FOR KEY VARIABLES

Domestic economic activity rose faster than forecasted

		II/10	III/10	IV/10	I/11	II/11	III/11
3M PRIBOR	p	1.1	1.0	1.1	1.4	1.7	2.1
(percentages)	o	1.3	1.2	1.2	1.2	1.2	1.2
CZK/EUR exchange rate (levels)	p	25.2	25.1	25.1	24.9	24.9	24.8
	o	25.6	24.9	24.8	24.4	24.3	24.4
Real GDP[a)]	p	1.9	1.2	0.8	0.7	1.4	2.3
(annual perc. changes)	o	2.3	2.6	2.7	2.8	2.2	-
Nominal wages[b)]	p	4.3	3.3	2.7	3.1	3.5	3.9
(annual perc. changes)	o	3.1	2.8	1.7	3.1	3.2	-

p – prediction, o – outturn
a) seasonally adjusted
b) in the business sector

CHART III.1.2

INFLATION

Annual inflation was stable in 2011 Q3
(annual percentage changes)

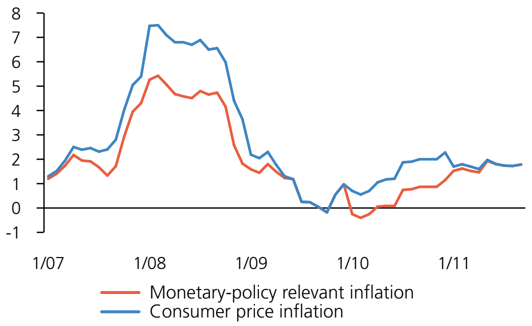


CHART III.1.3

INFLATION COMPONENTS

Annual food price inflation slowed, while fuel price inflation accelerated
(annual percentage changes; excluding indirect tax changes except for administered prices)

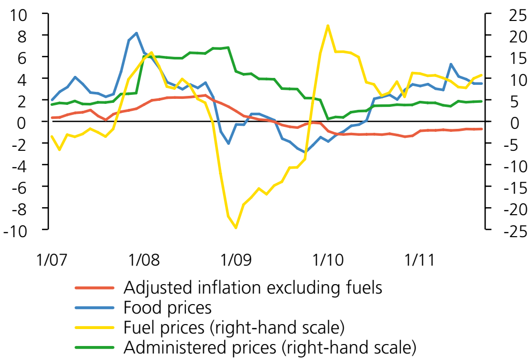
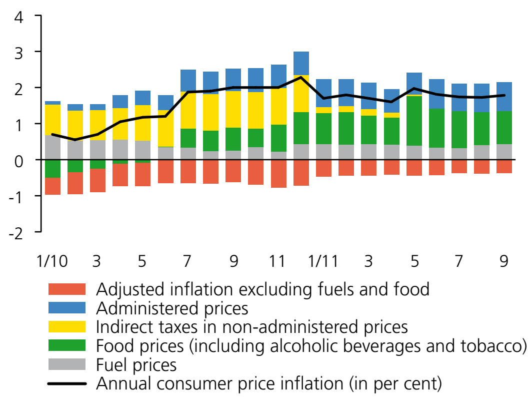


CHART III.1.4

STRUCTURE OF INFLATION

Food prices and administered prices contributed the most to annual inflation
(annual percentage changes; contributions in percentage points)



III.1.2 Current inflation

Annual inflation[14] was stable in 2011 Q3. After slowing slightly in July, it was at the same level in September as in June (1.8%; see Chart III.1.2). Commodity prices are still the main source of inflation. Inflation pressures from the domestic economy are not apparent. The broadly stable path of inflation, however, masked an unchanged contribution of administrative effects and contrary changes in some of its market components, as a decline in annual food price inflation was offset by higher fuel price inflation and less negative adjusted inflation excluding fuels (see Chart III.1.3).

Turning to the **structure of annual inflation**, the effect of market prices still slightly dominated owing to continued growth in food and fuel prices; the contribution of market prices to annual consumer price inflation was unchanged (1 percentage point in September; see Chart III.1.4). The contribution of administrative factors, i.e. the effects of changes to indirect taxes (zero at present) and administered prices, was somewhat lower and also unchanged from June. **Monetary-policy relevant inflation** overlapped with headline inflation, reaching 1.8% in September (see Chart III.1.2).

However, the contribution of **administered prices** to annual inflation was still relatively high (0.8 percentage point in September; see Chart III.1.4). In Q3, changes were made to numerous prices of administered items; in particular there were increases in natural gas prices for households, regulated rents, municipal public transport fares and education fees. Changes in electricity prices and water supply and sewerage collection charges made in previous quarters also contributed to annual administered price inflation (4.6% in September). Annual administered price inflation was also partly affected by a high base for natural gas prices. The following text assesses the evolution of the main components of inflation excluding the effect of tax changes.

Annual **market price inflation**, as measured by net inflation, was also broadly stable in 2011 Q3 (1.2% in September). The generally subdued growth in market prices was, however, a result of the aforementioned contrary movements in their main components, i.e. food and fuel prices versus adjusted inflation excluding fuels. Chart III.1.4 shows that the contribution of food prices to annual market price inflation was again the biggest, although it did decrease somewhat. The contribution of fuel prices was less significant due to their low weight. A persisting annual decline in prices within adjusted inflation excluding fuels again fostered low inflation, confirming the significant effect of subdued demand and the absence of inflationary pressures from the domestic economy. Also, the mostly falling import prices of final products with a high degree of processing for the consumer market, reflecting, among other things, the earlier exchange rate appreciation, helped

14 Measured by year-on-year growth in consumer prices.

to keep adjusted inflation low (for more details see *Import prices*). The still fast growth in global prices of energy commodities passed through noticeably to consumer prices of fuels and to housing prices (in expenditure on energy commodities such as natural gas).

Food prices recorded slowing annual growth in 2011 Q3 from the previous quarter's high levels, which had been due to a surge in bread product prices (see Chart III.1.5).[15] A closer look at the structure reveals that the fall in annual food price inflation in Q3 (from 4.2% in June to 3.5% in September) was caused primarily by an unusually sharp fall in prices of fruit and vegetables in August (see Chart III.1.6). The slowdown in food price inflation was also due to base effects for some items. However, annual growth in prices of bread products and cereals picked up further owing to higher prices of bread.[16] The current sharp fall in agricultural producer price inflation has so far passed through to consumer food prices to only a limited extent.

Unlike food prices, which are heavily dependent on the volatile prices of key inputs, **adjusted inflation excluding fuels**, comprising prices of products with a high degree of processing and services, remained broadly flat. Its annual negative level moderated slightly compared to June, to -0.7% in September. This insignificant change was due to a smaller annual decline in prices of other tradable commodities (to -2.4% in September; see Chart III.1.7). This was fostered by slower year-on-year appreciation of the koruna-euro exchange rate via import prices of products for the consumer market. By contrast, annual growth in prices of non-tradable commodities (excluding administered prices) slowed to a historical low of 0.4% amid persisting low demand and subdued wage growth.

Annual growth in **fuel prices** rose in 2011 Q3 (to 10.7% in September) despite declining annual growth in world oil prices. This was due to slower annual appreciation of the koruna-dollar exchange rate.[17]

By international comparison, consumer prices as measured by the **HICP** continued to rise more slowly in the Czech Republic than on average in the EU countries in 2011 Q3. According to Eurostat's latest estimate, annual HICP growth in the Czech Republic was 2.1% in September, while the average figure for the EU countries was much higher, standing at 3.3% in the same month.

15 Annual food price growth peaked at 5.3% in May. The high growth in bread product prices was a reaction to previous strong growth in agricultural producer prices and, to a lesser extent, energy prices.
16 For example annual growth in bread prices rose from 15.1% in 2011 Q2 to 24.7% in 2011 Q3, and prices of bakery products rose from 29% to 35.5% in the same period.
17 The koruna-dollar exchange rate appreciated by 5.6% in September compared to 20.1% in June.

CHART III.1.5

FOOD PRICES

Food price inflation slowed

(annual percentage changes)

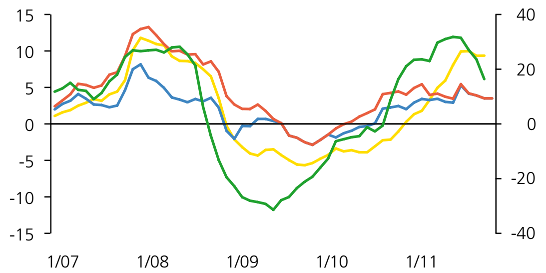


CHART III.1.6

COMPONENTS OF FOOD PRICES

Fruit and vegetable prices slowed, but bread product prices accelerated

(annual percentage changes; source: CZSO)

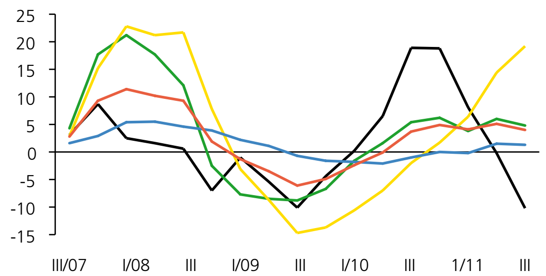


CHART III.1.7

ADJUSTED INFLATION EXCLUDING FUELS

The annual decline in prices within adjusted inflation moderated slightly

(annual percentage changes)

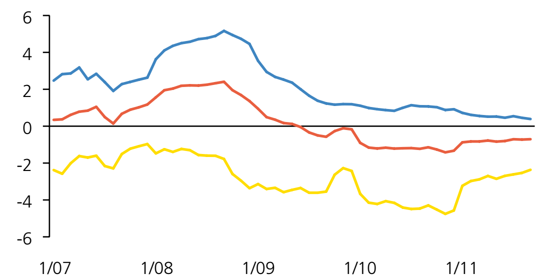


CHART III.2.1

IMPORT PRICES AND PRODUCER PRICES

Import price inflation accelerated again, industrial producer price inflation was flat, and agricultural producer price inflation fell sharply

(annual percentage changes)

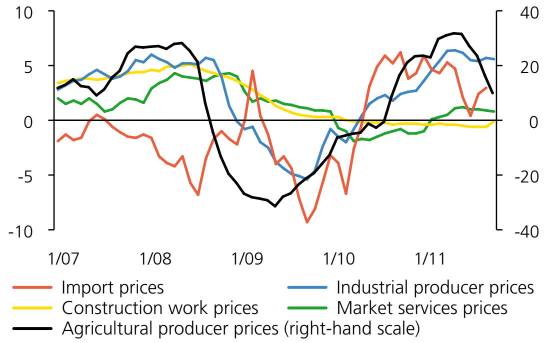


CHART III.2.2

IMPORT PRICES

Import price inflation continued to be driven mainly by prices of imported commodities and semi-finished products

(annual percentage changes; contributions in percentage points)

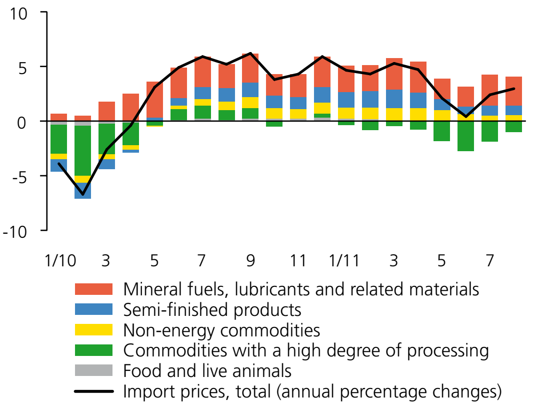
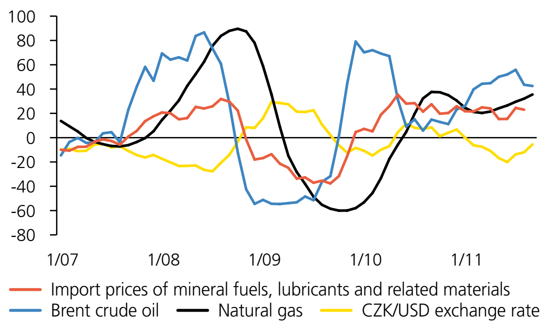


CHART III.2.3

MINERAL FUELS

The high growth in prices of energy commodities was dampened to a weakening extent by year-on-year appreciation of the koruna-dollar exchange rate

(annual percentage changes)



III.2 IMPORT PRICES AND PRODUCER PRICES

The continuing fast annual growth in prices of key commodities on world markets was dampened to a weakening extent by exchange rate appreciation, fostering a pick-up in annual growth in import prices. The growth in commodity import prices was again reflected most of all in prices of producers at the early stages of the production chain. By contrast, import prices of products with a high degree of processing continued falling. Annual producer price inflation in other high-value-added branches of manufacturing rose modestly, but was not across the board in nature. Agricultural producer price inflation slowed sharply and food industry prices also recorded more modest growth. Prices in market services also rose more slowly, whereas the decline in prices in construction slowed noticeably.

III.2.1 Import prices

In the first two months of 2011 Q3, the annual rise in **import prices** continued to be driven by prices of key commodities on world markets (see Chart III.2.2). According to the latest CZSO data for August, their annual growth accelerated again (to 3%) owing to a lower rate of exchange rate appreciation and to volatile foreign prices of some commodities.

Fast growing prices of imported **mineral fuels** remained the biggest contributor to annual import price inflation in the first two months of 2011 Q3 (see Chart III.2.2). Their contribution increased again compared to June, reaching 2.7 percentage points in August. The gradual pick-up in annual growth of world oil prices, observed since 2010 Q4, peaked in July at 55.8%; in August their rate of growth fell sharply to 43.5%. Annual growth in world natural gas prices, which follow oil prices with a lag, started accelerating in 2011 Q2, reaching 32.1% in August. The faster overall annual growth in energy commodity prices in August than at the end of 2011 Q2, which was dampened to a weakening extent by year-on-year appreciation of the koruna-euro exchange rate (see Chart III.2.3), led to a renewed pick-up in growth of import prices of mineral fuels from 15.4% in June to 23% in August.

Conversely, annual growth in import prices of **non-energy commodities** continued decreasing from its record high of more than 40% in April to 15% in August. Nonetheless, their contribution to import price inflation reached 0.5 percentage point. Annual growth in import prices of chemicals and related products accelerated compared to June (to 5% in August), as did that of import prices of **semi-finished products** (to 4% in August); in both cases this was probably due largely to slower year-on-year appreciation of the koruna. Import prices of **food** continued to show a modest annual decline to -0.4% in August. Prices of vegetable and animal oils continued to record strong growth, which moderated from high levels of over 40%, but was still high (30.1% in August).

Import prices of raw materials and semi-finished products thus recorded annual growth, which remained high, especially for energy and non-energy commodities. However, import prices of **high-value-added commodities**[18] continued falling in year-on-year terms (see Table III.2.1) owing to the strengthening exchange rate and lower growth of foreign prices of such commodities compared to raw materials. In August, the marked weakening of the annual decline in import prices of these commodities chiefly reflected a moderation of the annual appreciation of the koruna-euro and koruna-dollar rates.

III.2.2 Producer prices

Industrial producer prices

The slowdown of **industrial producer price inflation** from high levels exceeding 6%[19] halted in 2011 Q3. These prices recorded annual growth of around 5.5% in Q3 and 5.6% in September (see Chart III.2.4).

The view of the causes and **structure of the growth in industrial producer prices** was little changed from the previous report. The growth was strongly affected to the same extent by fast growing import prices of major commodity inputs, although there were some changes in structure (particularly an unwinding of the effect of non-energy commodity inputs). These cost pressures fed through quickly to prices of producers at the early stages of the production chain (see Chart III.2.4 and Chart III.2.5). Prices in the food industry also continued to rise apace, reflecting the lagged pass-through of high agricultural producer prices to prices in manufacturing. Producer prices in other sectors rose slightly, but this change did not imply across-the-board pass-through of cost pressures to prices of high-value-added commodities.

The overall annual price growth in industry in 2011 Q3 was again due to a significant contribution of producer prices in the **food industry** (1.4 percentage points), although their annual growth slowed somewhat compared to June (to 8.4%). The same contribution was recorded by prices in the **manufacture of coke and refined petroleum products**, which conversely accelerated (from 17.7% in June to 24% in September). By contrast, the contribution of prices of **basic metals** continued falling (to 0.8 percentage point), mainly because of slower annual growth of import prices of metal-based semi-finished products. Despite moderating markedly, however, producer price inflation remained high, reaching 5.9% in September.

18 This category contains machinery, transport equipment and miscellaneous manufactured articles.

19 The previous pick-up in their annual growth had peaked in April at 6.4%.

TABLE III.2.1

STRUCTURE OF IMPORT PRICE INFLATION

Import prices rose in most import categories, although they fell again for high-value-added commodities

(annual percentage changes)

	5/11	6/11	7/11	8/11
IMPORTS, TOTAL	2.1	0.4	2.4	3.0
of which:				
food and live animals	-0.1	-0.7	-0.6	-0.4
beverages and tobacco	6.9	3.8	6.6	7.7
crude materials inedible, except fuels	33.8	20.4	13.6	15.0
mineral fuels and related products	15.3	15.4	24.5	23.0
animal and vegetable oils	42.1	31.2	29.0	30.1
chemicals and related products	4.1	3.4	3.8	5.0
manufactured goods classified chiefly by material	4.8	3.1	4.3	4.0
machinery and transport equipment	-5.5	-7.1	-5.5	-4.0
miscellaneous manufactured articles	-3.5	-5.3	-3.2	-1.9

CHART III.2.4

INDUSTRIAL PRODUCER PRICES

Annual industrial producer price inflation was flat in 2011 Q3

(annual percentage changes; contributions in percentage points)

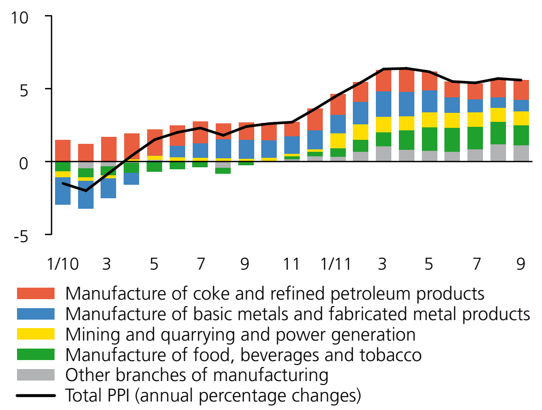


CHART III.2.5

PRODUCER PRICES BY MAIN INDUSTRIAL GROUPINGS

The rising prices of commodities fed through to prices of intermediate goods and non-durable goods

(annual percentage changes)

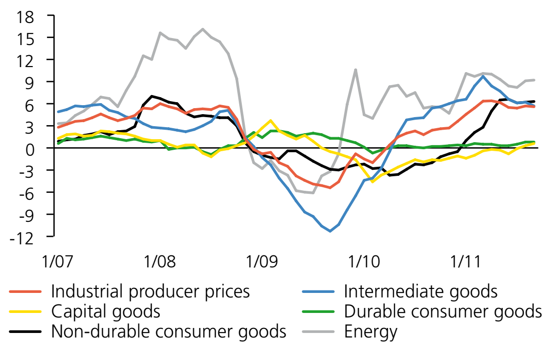


Chart III.2.6

PRICES OF METALS AND REFINED PETROLEUM PRODUCTS

The slowdown in growth in prices of imported semi-finished products passed through quickly to producer prices
(annual percentage changes)

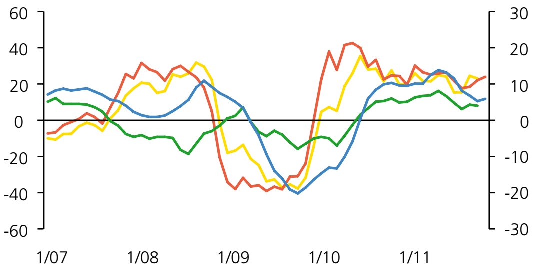
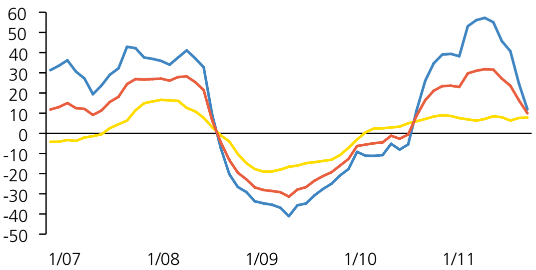


Chart III.2.7

AGRICULTURAL PRODUCER PRICES

Annual agricultural producer price inflation fell sharply
(annual percentage changes)



Industrial producer price inflation in 2011 Q3 was also still affected by continued price growth in the **electricity, gas and steam industry** (4% in September) and in the water supply and sewage-related services industry (6.3% in September). By contrast, annual price growth in mining and quarrying slowed further (to 5.9%). Overall, the contribution of these industries to annual industrial producer price inflation decreased slightly to 0.9 percentage point in September.

After falling in 2011 Q2, inflation in **other branches of manufacturing** rose slightly. Its contribution to annual industrial producer price inflation thus increased to 1.1 percentage point in 2011 Q3. Producer prices increased in most branches, but a pick-up in annual growth was recorded only in those closely related to oil products and in the machinery and equipment category. Producer prices in the manufacture of transport equipment and computer, electronic and optical equipment kept falling.

Agricultural producer prices

The strong annual growth in agricultural producer prices in 2011 H1, which had been putting upward pressure on food prices, eased noticeably in 2011 Q3. According to the latest data for September (9.9%), it was at about one-third the level of the highest growth figures observed in late Q2 and early Q3 (see Chart III.2.7). This change in the agricultural price inflation trend was due solely to crop product prices, whose previous high annual growth slowed significantly. By contrast, livestock product prices recorded broadly stable annual growth of around 8% in the period under review.

The marked slowdown in agricultural producer price inflation in 2011 Q3 was a result of the dissipation of most of the key factors that had caused these prices to increase at the end of 2010 and in 2011 H1. In particular, this year's favourable weather conditions – together with the return of some traditional exporters to the world market – led to a slight fall in global prices of crop commodities. The domestic harvest was also well above average from the longer-term perspective. At the same time, some traditionally volatile agricultural producer price items (potatoes, vegetables) started to record significant annual declines. The year-on-year appreciation of the koruna-euro exchange rate in 2011 Q3 also had an anti-inflationary effect on domestic agricultural producer prices.

Other producer prices

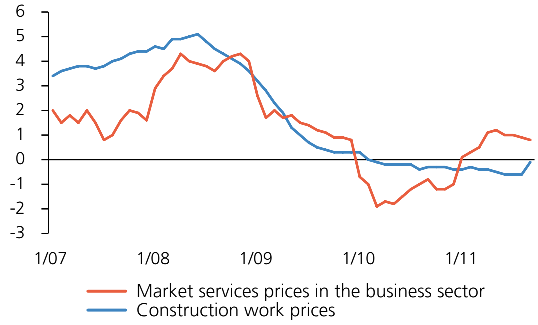
Amid persisting low construction investment demand, **prices of construction work** continued to show an annual decline in 2011 Q3 (see Chart III.2.8). For the first time in a while, however, this decline slowed noticeably (from -0.6% in June to -0.1% in September). Annual growth in prices of materials and products consumed in the construction industry meanwhile decreased somewhat (to 2.6% in September).

By contrast, prices of market services continued to rise. Their growth moderated slightly in 2011 Q3 (to below 1%). Services with rising prices continued to predominate, but their growth was modest due to low domestic demand. Advertising services and market research, where prices increased by 5% year on year in September, were the only exception.

CHART III.2.8

OTHER PRICE CATEGORIES

The year-on-year decline in prices of construction work slowed, while growth in prices of market services moderated further
(annual percentage changes)



III.3 DEMAND AND OUTPUT

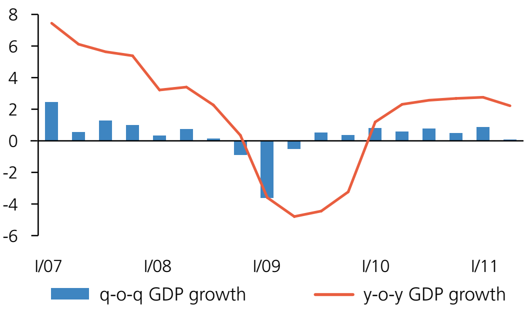
Annual real GDP growth slowed by 0.6 percentage point to 2.2% in 2011 Q2.[20] Quarter-on-quarter output growth was also noticeably slower (by 0.1%) than in the previous quarter. The biggest contributor to annual GDP growth was net exports thanks to a persisting lead of export growth over import growth. However, their contribution decreased. Gross fixed capital formation and changes in inventories also contributed to the GDP growth, whereas the negative contribution of final consumption expenditure deepened slightly. On the supply side, the economic growth was due mainly to manufacturing, although its contribution decreased compared to the previous quarter owing to weaker external demand.

CHART III.3.1

GROSS DOMESTIC PRODUCT

GDP growth slowed in 2011 Q2

(annual and quarterly percentage changes at constant prices; seasonally adjusted data)



III.3.1 Domestic demand

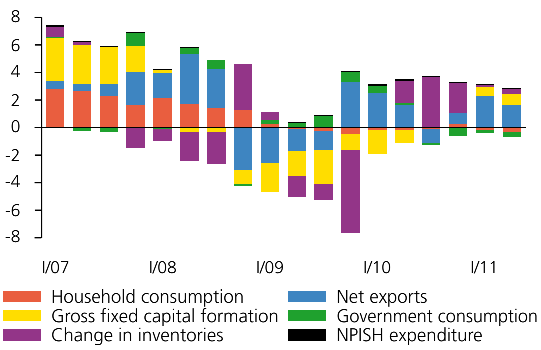
Annual **domestic demand** growth rose slightly in 2011 Q2 but remained subdued and did not exceed 1%. The domestic demand growth was due to positive year-on-year changes in inventories and fixed investment. Conversely, the decline in household and government consumption continued, deepening slightly compared to 2011 Q1 (see Chart III.3.2).

CHART III.3.2

STRUCTURE OF ANNUAL GDP GROWTH

Net exports were the biggest contributor to the GDP growth

(contributions in percentage points; seasonally adjusted data)



Final consumption

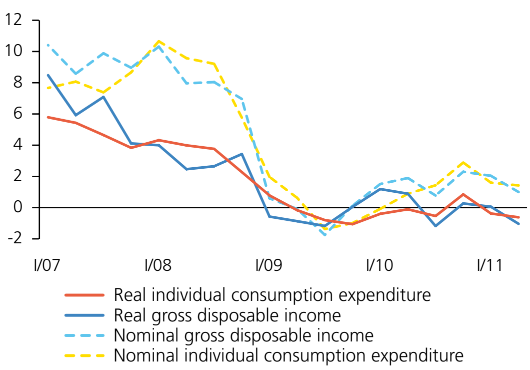
In 2011 Q2, **household consumption** continued to record an annual decline, which deepened to -0.7% compared to the previous quarter.[21] The continuing annual decline in household consumption expenditure, observed since 2009 Q2[22] in connection with the impacts of the global recession on the domestic economy, was accompanied by structural changes in consumption. Households continued to reduce their expenditure on non-durable goods, and their spending on durable goods decreased again after rising temporarily in Q2. Growth was recorded only for expenditure on semi-durable goods and services, but this was not significant.

CHART III.3.3

HOUSEHOLD CONSUMPTION EXPENDITURE

Household consumption fell, in line with real disposable income

(annual percentage changes)



The main causes of the persisting subdued household consumption are the same as in previous quarters, particularly weakening growth in their **nominal gross disposable income**, the real purchasing power of which was moreover reduced by annual inflation[23] (see Chart III.3.3). In 2011 Q2, amid a combination of a further slowdown in nominal disposable income growth and a more than 2% rise in the

20 The assessment of the evolution of GDP expenditure and GDP sources is based on seasonally adjusted data from the CZSO's quarterly national accounts. At the start of December 2011, the CZSO will publish a significant revision of these data following on from the already released revision of the annual national accounts.

21 Seasonally adjusted data.

22 2010 Q4, when household consumption saw annual growth (0.4%), was an exception.

23 As measured by the household consumption deflator.

consumption deflator, the real disposable income of households fell by 1% year on year. In addition, the **saving rate**, which in recent quarters has been at quite a high level of around 10%, indicated continuing prudent behaviour of households amid a still uncertain labour market outlook and concerns about the impacts of fiscal consolidation. The restrained consumption behaviour of households was also evidenced by persisting subdued consumer credit growth, which is assessed in section III.5.2.

The low annual nominal gross disposable income growth (of 1%) was again driven mostly by **income from wages and salaries** in 2011 Q2 (see Chart III.3.4).[24] An insignificant positive contribution to income growth was also recorded by property income, payments of taxes and social contributions. The other components of household income were by now decreasing.

The latest available **leading indicators** are not signalling any recovery in household consumption in the future period. The seasonally adjusted real retail sales data for July and August showed positive growth only in the automotive segment, while real sales in the other subcategories of this sector declined. The latest results of the September CZSO business survey do not indicate any change in the consumption behaviour of households either, as the consumer confidence indicator remains on a downward trend (see Chart III.3.5), mainly reflecting a deterioration in households' expectations regarding the overall economic situation and unemployment and consequently a reduced ability to save.

Real **government final consumption expenditure** continued to decline in 2011 Q2. This fall primarily reflected the implementation of government austerity measures. The year-on-year decline (of 1.4%) was bigger than in the previous quarter.

Investment

Fixed investment, which recovered at the start of this year after almost three years of annual decline, continued to rise in 2011 Q2[25] (see Chart III.3.6). Fixed investment rose both in year-on-year (by 3.6%) and quarter-on-quarter terms. Amid deteriorating expectations about future economic developments, however, continuation of the upward trend in investment activity is surrounded by considerable uncertainty.

As in previous quarters, a fixed investment recovery was not observed in all sectors. The year-on-year growth continued to be driven almost exclusively by **non-financial corporations**, where investment increased by more than 12% in Q2 (see Table III.1). According to the pilot results of a business survey conducted in non-financial corporations jointly by the CNB and the Confederation of Industry

24 For details see section II.4 *The labour market*.
25 Fixed investment declined year on year throughout 2010.

CHART III.3.4

DISPOSABLE INCOME

Growth of nominal household gross disposable income slowed slightly
(annual percentage changes; contributions in percentage points; current prices)

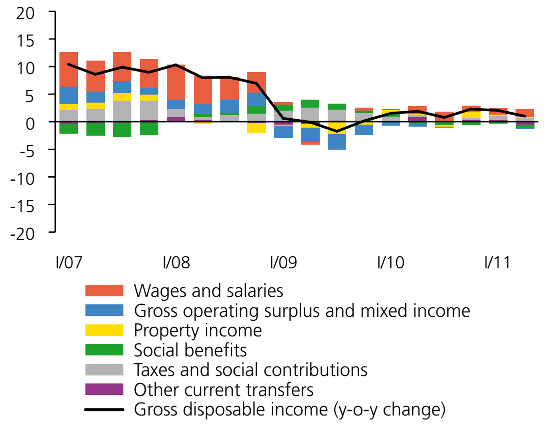


CHART III.3.5

CONSUMER CONFIDENCE INDICATOR

Household confidence is decreasing
(2005 average = 100; seasonally adjusted data)

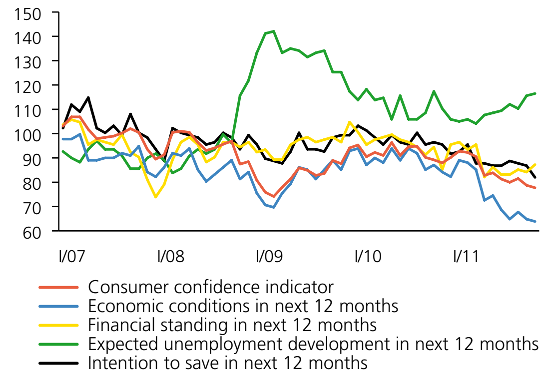


CHART III.3.6

FIXED CAPITAL FORMATION

Fixed investment continued to rise in 2011 Q2
(annual percentage changes; contributions in percentage points; constant 2000 prices)

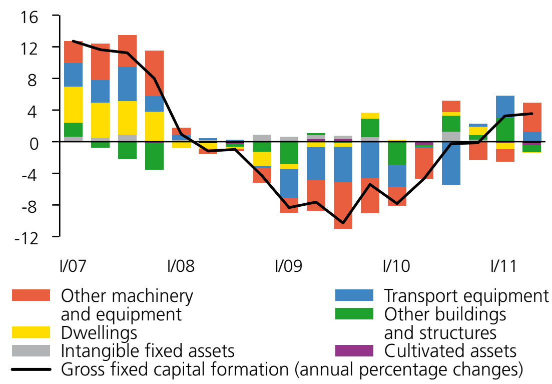


Table III.3.1

INVESTMENT BY SECTOR

Investment growth continued to be driven mainly by non-financial corporations

(constant prices; CNB calculation)

	III/10	IV/10	I/11	II/11
Annual percentage changes				
Non-financial corporations	2.3	2.3	8.0	12.2
Households	-2.2	4.6	-0.8	-6.7
General government	-8.7	-12.8	-2.2	-3.6
Financial corporations	89.2	75.2	-12.8	-27.6
Nonprofit institutions serving households	6.0	5.0	4.7	3.5
Share in total fixed investment in per cent				
Non-financial corporations	51.2	48.6	53.3	56.8
Households	24.2	24.5	24.9	21.8
General government	21.5	23.6	19.6	19.5
Financial corporations	2.5	2.6	1.5	1.2
Nonprofit institutions serving households	0.7	0.6	0.7	0.7

Chart III.3.7

INVESTMENT IN DWELLINGS

Investment in dwellings, housing starts and housing completions all decreased in 2011 Q2

(annual percentage changes)

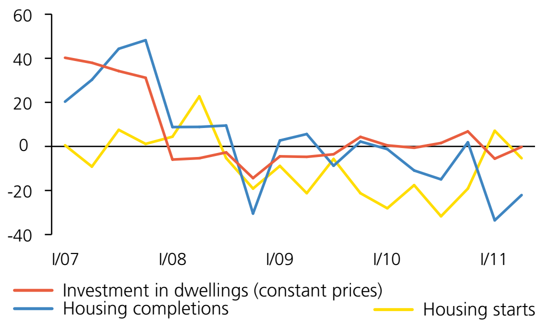
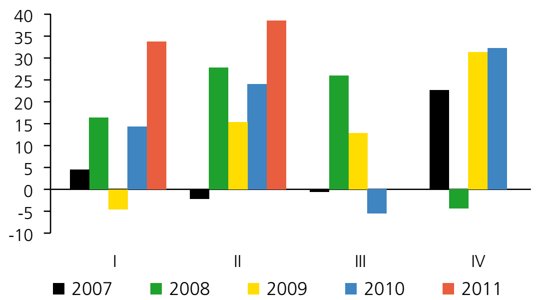


Chart III.3.8

NET EXTERNAL DEMAND

Net exports increased significantly year on year in 2011 Q2

(CZK billions; constant 2000 prices; seasonally adjusted data)



of the Czech Republic this year, however, the positive balance of the expected change in investment expenditure at the 6-month and 12-month horizons is gradually decreasing. This phenomenon was most apparent in the results of the latest September survey and can be viewed as an expression of corporations' weakening optimism regarding future orders.

Unlike in the case of non-financial corporations, fixed investment in the **household sector** kept falling year on year in 2011 Q2, with the decline increasing significantly to 6.7%. However, the decline in investment in dwellings, which accounts for a large proportion of total household investment, was insignificant (0.2%; see Chart III.3.7). However, its volatility, and in particular the falling numbers of housing starts and completions and the modest growth in loans for house purchase, do not suggest any marked improvement in the outlook for housing demand in the period ahead. On the contrary, the mostly negative year-on-year changes in these indicators indicate a generally prudent approach of developers and households to investment in dwellings, mainly because of uncertainty regarding future economic developments and the situation on the labour market.

The contribution of additions to **inventories** to annual GDP growth increased slightly in 2011 Q2 (to 0.4 percentage point) but was well below the levels observed in 2010, when additions to inventories recorded a recovery following a crisis-related fall in 2009 (see Chart III.3.2). The subdued evolution of additions to inventories was broadly in line with the September results of the CNB business survey. According to this survey, inventories should follow a similar trend in 2011 Q3.

III.3.2 Net external demand

The year-on-year growth in **net exports of goods and services**[26] visible in the previous two quarters continued into 2011 Q2. The net export surplus increased by CZK 14.5 billion year on year. In quarter-on-quarter terms the increase was more modest at CZK 4.8 billion (see Chart III.3.8). The sharp year-on-year increase in net exports was due to exports rising faster than imports, albeit less than in the previous quarter (see Chart III.3.9). The contribution of net exports to GDP growth was again positive, but was noticeably smaller than in the previous quarter.[27]

The net export surplus was achieved amid a continuing slowdown in foreign trade turnover, observed for the fourth consecutive quarter (see Chart III.3.9). The decrease in its annual growth rate below 10% in Q2 was chiefly due to a sharp slowdown in growth of **total exports** (of 5.5 percentage points compared to 2011 Q1, to 9.4%).

26 At 2000 prices, seasonally adjusted.
27 See Chart III.3.2.

The noticeably slower export growth reflected above all weaker external demand in the Czech Republic's major trading partner countries and increased uncertainty about future economic developments.

Year-on-year growth in **total imports**, which is affected mainly by the high import intensity of Czech exports, also decreased noticeably in 2011 Q2. Their growth rate moderated by 4.8 percentage points compared to the previous quarter, to 7.9% (see Chart III.3.9). This was mostly due to imports for intermediate consumption, associated with a further weakening of growth in the export activities of Czech businesses. Growth in imports for final consumption also decreased, owing to persisting low domestic demand. Growth in investment imports was also lower than in the previous quarter, but remained high.

III.3.3 Output

The gradual decrease in quarter-on-quarter growth in **gross value added** at basic prices changed into a decline of 0.8% in 2011 Q2.[28] In year-on-year terms, gross value added continued to rise, but the growth moderated noticeably compared to the previous quarter (from 3.5% to 1.7%; see Chart III.3.10). In sectoral terms, the continuing growth in value added was again due mostly to manufacturing and, to a lesser extent, to some services.

The contribution of **industry** to annual gross value added growth decreased the most, but remained the highest (2 percentage points). There was a pronounced decrease in value added growth in manufacturing from the previous double figures to just below 10%. The decrease in the contribution of industry to value added growth in Q2 was also due to a renewed annual decrease in the mining and energy supply sectors.

Slowing, but still fast, growth in **manufacturing** (10% in Q2), supported mainly by exports (primarily of motor vehicles, trailers and semi-trailers) [29], remained the key factor for value added in industry. This was confirmed by the statistics of sales of own products and industrial services, within which – even after the growth moderated – direct export sales continued to rise quickly (by 16.4% year on year at current prices), whereas domestic sales growth slowed to just 2.1% in 2011 Q2. These results were consistent with the continuing, although slowing, real growth in goods exports according to the CZSO's national accounts (of 11.2%).[30]

28 Seasonally adjusted figure.
29 The following branches contributed to the annual real industrial production growth above all in 2011 Q2: manufacture of motor vehicles, trailers and semi-trailers (3.8 percentage points), manufacture of machinery and equipment (1.4 percentage points) and manufacture of electrical equipment (0.9 percentage point).
30 Seasonally adjusted figure.

CHART III.3.9

EXPORTS AND IMPORTS

Foreign trade turnover continued to slow in 2011 Q2, but exports rose faster than imports

(annual percentage changes; percentage points; constant prices; seasonally adjusted data)

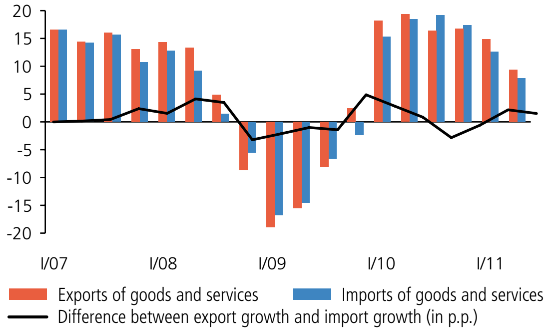


CHART III.3.10

CONTRIBUTIONS OF BRANCHES TO GVA GROWTH

Year-on-year value added growth continued to be driven by manufacturing in Q2

(contributions in percentage points; annual percentage changes; seasonally adjusted data)

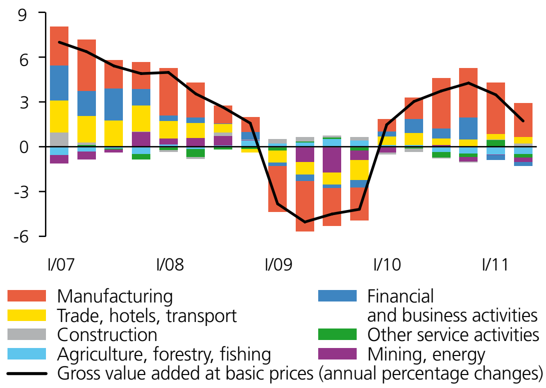


CHART III.3.11

INDUSTRIAL PRODUCTION

The trend component of the volume of industrial production has been decreasing since June

(basic index; year 2005 = 100)

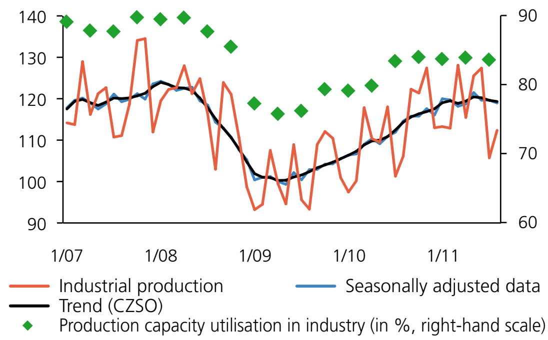


CHART III.3.12

NEW ORDERS IN INDUSTRY

New industrial orders decreased year on year in August
(annual percentage changes)

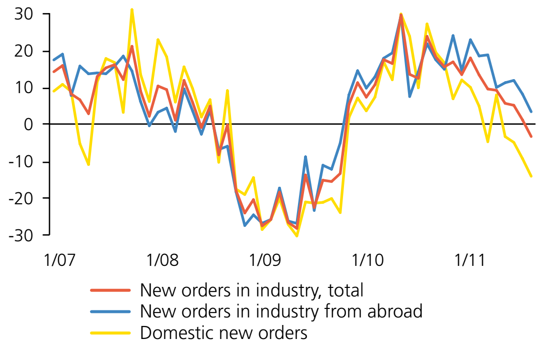


CHART III.3.13

BARRIERS TO GROWTH IN INDUSTRY

Insufficient demand is still the main barrier to growth in output in industry
(percentages)

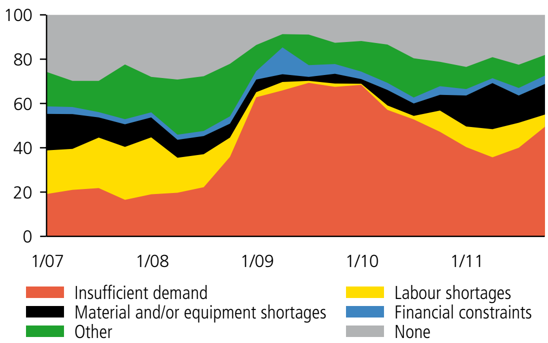
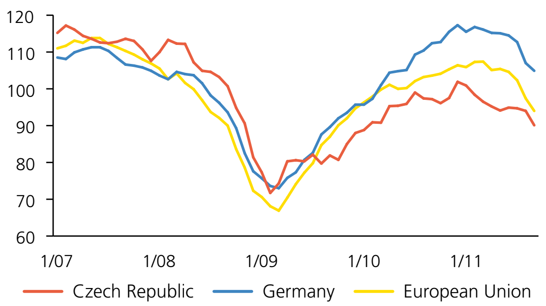


CHART III.3.14

CONFIDENCE INDICATORS

The confidence indicator is lower in the Czech Republic than in the EU and Germany, where, however, it is falling more rapidly
(long-term average = 100; seasonally adjusted data; source: Eurostat)



According to the latest data for August, the slowdown in annual industrial production growth continued into the first two months of Q3 (to 3.8% in August[30]). The trend component of the volume of industrial production has thus been decreasing month on month since June. This is starting to be reflected in a renewed slight decline in **capacity utilisation** in industry (see Chart III.3.11). The outlook for the months ahead is not optimistic either, as **new orders in industry** decreased year on year in August (see Chart III.3.12). At the same time, domestic orders are showing a pronounced year-on-year decline and growth in foreign orders has slowed noticeably. According to the CZSO's survey, industrial businesses expect aggregate demand to deteriorate further in the months to come. From their perspective, insufficient demand is thus still the largest – and again strengthening – **barrier to growth in output** in industry (see Chart 3.13).

Unlike in industry, the contribution of **services and trade** to year-on-year growth in total gross value added was slightly negative in 2011 Q2 (-0.1 percentage point). Positive contributions to output growth came only from trade and hotels and restaurants, health and some other services. The real retail sales data suggest that the continued gross value added growth in trade was mostly driven by car sales; the contributions of sales in other categories of retail goods were less significant. In addition, it is likely that value added growth in trade will no longer be fostered by sales in these other categories in 2011 Q3, as they again recorded year-on-year decreases in July and August. Sales continued to increase only in the automotive segment.

Construction recorded a modest annual rise in gross value added in 2011 Q2. This growth, however, did not mean a reversal in trend, as – according to the latest sector statistics – the contraction in construction continued into July and August and was especially significant in civil engineering. The falling approximate value of building permits and value of new construction work orders at the same time indicate that this trend will continue in the months ahead. The results of the CZSO business survey show a modest improvement in expectations, but negative prospects of businesses in construction are still strongly prevalent.

In these circumstances, the **overall confidence indicator** declined in 2011 Q3 according to the CZSO business survey. The deteriorating business and consumer confidence was due to the current increased uncertainty regarding external demand and the economic situation in the coming months. By international comparison, the confidence indicator is lower in the Czech Republic than in its major trading partner countries, where, however, it has been falling more rapidly in recent months (see Chart III.3.14).

30 Seasonally adjusted figure.

III.3.4 Potential output and estimate of the cyclical position of the economy

According to the calculation of the **Cobb-Douglas production function**,[31] the GDP growth slowdown in 2011 Q2 was reflected in an opening of the output gap into negative values (-1.0%, compared to -0.5%[32] in 2011 Q1 according to revised data; see Chart III.3.16), whereas the rate of growth of potential output stayed almost the same as in the previous quarter (1.7%; see Chart III.3.15). According to the production function calculation, this trend will continue in the remaining quarters of this year. The rate of growth of potential output will not change much and the output gap will open further into negative values (see Chart III.3.16). By contrast, the rate of growth of potential output is expected to slow slightly during 2012 and the output gap will start to close. Compared to earlier calculations, however, its switch to positive values has moved back to the end of 2013.

The breakdown of the **contributions of the individual factors** entering the baseline production function reveals that neither the contribution of aggregate productivity, which is the main factor of potential output growth, nor the contribution of capital will change much over the forecast horizon. The minor changes in the rate of growth of potential output will thus be due mainly to the contributions of equilibrium employment (see Chart III.3.17), which will reflect the effect of this year's slowdown in annual GDP growth with the usual lag.

An alternative estimate using the **HP filter**[33] suggests a similar evolution of the output gap as that indicated by the production function, but is associated with a slightly higher rate of growth of potential output (1.8% in 2011 Q2). The **Kalman filter** continues to indicate an even higher rate of growth of potential output (2.3% in 2011 Q2) and a much greater opening of the negative output gap (-4.3% of potential output). All the above methods are thus indicating that the output gap opened further into negative values in 2011 Q2. However, the dispersion between the calculations remains sizeable, pointing to a continued high degree of uncertainty surrounding the estimates of the current cyclical position of the economy.

31 The production function is computed in three ways using different input data. Coefficient λ = 10,000 is used to filter productivity in the HP filter. The estimates of future potential output and the output gap are based on the CNB's macroeconomic forecast. The inclusion of the forecast helps to reduce the deviation of the HP filter at the end of the data sample.
32 Average of the three calculations.
33 The estimate using the HP filter also used coefficient λ = 10,000.

CHART III.3.15

POTENTIAL OUTPUT

The rate of growth of potential output was little changed in 2011 Q2 according to the calculation of the production function

(annual percentage changes)

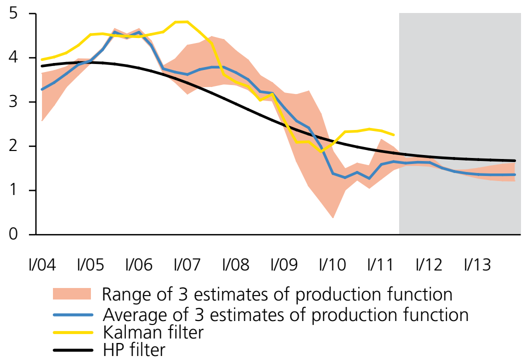


CHART III.3.16

OUTPUT GAP

The output gap opened into more negative values in 2011 Q2

(in % of potential output)

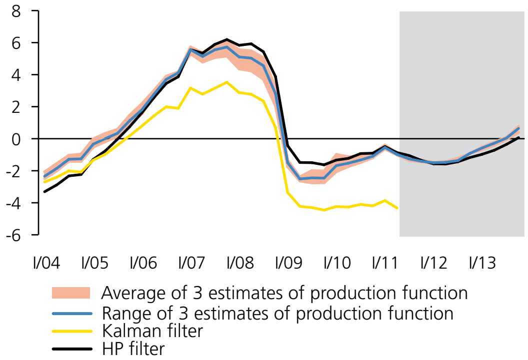


CHART III.3.17

CONTRIBUTIONS TO POTENTIAL OUTPUT GROWTH

The minor changes in the rate of growth of potential output over the forecast horizon are due mainly to changes in equilibrium employment

(baseline production function; annual percentage changes)

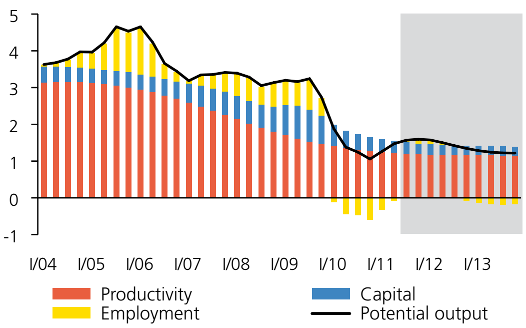


CHART III.4.1

LABOUR MARKET INDICATORS

Modest growth in employment and growth in the average wage continued into 2011 Q2
(annual percentage changes)

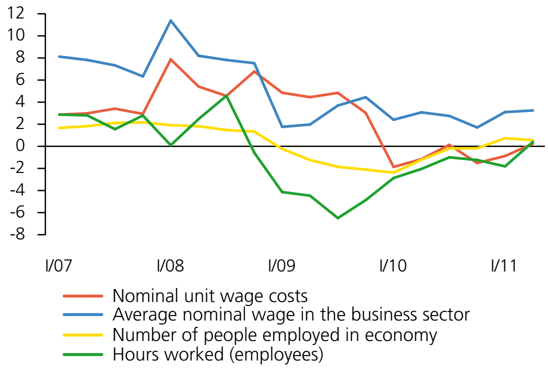
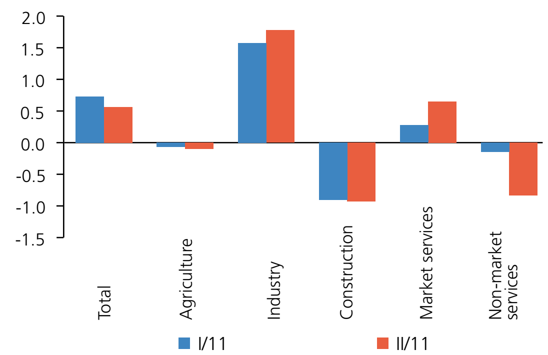


CHART III.4.2

EMPLOYMENT BREAKDOWN BY BRANCHES

Employment increased most of all in industry, fell in construction and also declined modestly overall in services
(contributions in percentage points to annual growth; selected branches; source: LFS)



III.4 THE LABOUR MARKET

Employment, whose year-on-year growth rate stayed roughly at the Q1 level, continued to rise modestly in 2011 Q2. The general unemployment rate recorded a further year-on-year decline. The registered unemployment rate also continued to decline gradually in the first three quarters of this year. Annual average nominal wage growth picked up slightly, but the average wage in the non-business sector kept falling. Growth in whole-economy productivity slackened. Nominal unit wage costs saw a marginal year-on-year increase in 2011 Q2 as a result of a rise in the volume of wages and salaries amid slower GDP growth in 2011 Q2.

III.4.1 Employment and unemployment

Annual growth in employment, which rebounded in 2011 Q1, continued into Q2 (see Chart III.4.1). **Total employment** rose by 0.6%. In absolute terms this meant an increase in the number of employed persons of 27,400 compared to the same period last year. Adjusted for seasonal effects, employment also rose in quarter-on-quarter terms (by 0.3%). At the same time, the continuing sluggish recovery of employment[34] was accompanied by changes in the growth structure; while the previous relatively fast growth in the number of entrepreneurs slowed noticeably (to 0.7%), the number of employees,[35] after a previous decline, increased year on year (by 0.5%).

Industry, where the number of employed people grew again in 2011 Q2 (see Chart III.4.2), remained the biggest contributor to the rise in employment. In year-on-year comparison, it recorded significant growth of 6.4%, which in absolute terms meant an increase in the number of employees of 86,700 (76,000 in Q1). Employment growth in export-oriented manufacturing (a year-on-year increase of 6.5%), which was also the biggest contributor to GDP growth, remained the key factor for continued growth of employment in industry. Employment growth in other branches of industry was less significant.

Employment in the **services sector**, after a slight increase in Q1, declined again in 2011 Q2. Its annual decline was only modest (0.3%, i.e. 9,200 persons) and was due mainly to government austerity measures, which primarily affected non-market services.[36] In market services, by contrast, the number of people employed rose significantly (see Chart III.4.2), although increased demand for labour was recorded only in some sectors – above all information and communication activities and financial intermediation and insurance. In a number of

34 In 2011 Q1 annual employment growth had been only 0.1 percentage point higher, at 0.7%.
35 Including members of production cooperatives.
36 The biggest slump in the number of employed persons (17,700 persons) was in health and social care. Sizeable declines were also recorded in public administration (8,000 persons), in education (8,300 persons) and in other activities (8,100 persons).

sectors employment so remained affected by the low level of domestic demand. For this reason, employment in the **construction sector** is continuing to decline sharply.

With employment growing faster than the labour force,[37] the **general unemployment rate**[38] decreased by 0.4 percentage point year on year in 2011 Q2. Adjusted for seasonal effects, it was flat at 7% in quarter-on-quarter terms. The **total registered unemployment rate** (MLSA) showed similar developments,[39] also declining by 0.4 percentage point year on year and by just 0.1% quarter on quarter to 9% in the same period (see Chart III.4.3). In 2011 Q3, the weak quarter-on-quarter decline in the registered unemployment rate continued further, reaching 8.9%.

The **Beveridge curve** indicated no notable positive changes on the labour market in terms of vacancies in 2011 Q2 and Q3, as the number of vacancies[40] in recent months has been broadly flat at around 38,000 (see Chart III.4.4). However, the number of unemployed persons decreased for the ninth consecutive month. In these circumstances, the Beveridge curve moved slightly to the left, practically in parallel with the horizontal axis.

III.4.2 Wages and productivity

Average nominal wage growth accelerated further in 2011 Q2, reaching 2.5%. The average real wage also increased, but its growth was significantly lower at just 0.7% on account of inflation (see Table III.4.1). As in previous quarters, the average wage growth was driven solely by wages in the business sector; after a sizeable annual upswing in 2011 Q1, they recorded only a very moderate acceleration of growth to 3.2% in Q2. By contrast, the average wage in the non-business sector decreased year on year for the fourth consecutive quarter as a result of government austerity measures, although the decline moderated further (to -0.9% in 2011 Q2).

The continuing subdued wage growth in the business sector was due mainly to still relatively fast (albeit slowing) production growth in numerous branches of industry, associated primarily with external demand. The significantly faster **productivity growth** than average wage growth observed in this sector since the start of 2010, i.e. during the economic upswing following the crisis-related decline, attests to very prudent wage-setting behaviour by entrepreneurs in that period. The main cause lies not only in persisting excess labour supply, but also in employers' cost-cutting motives linked with the need to offset their rising costs due to rapidly increasing prices of some inputs and with

37 Its growth is due to the upswing of economic activity which more than offset the shrinking working age population.
38 In the 15–64 age category. Measured by the ILO methodology according to the LFS.
39 Seasonally adjusted data.
40 Seasonally adjusted data.

CHART III.4.3

UNEMPLOYMENT RATE

The unemployment rate is falling gradually

(percentages; seasonally adjusted data; source: MLSA, CZSO, CNB calculation)

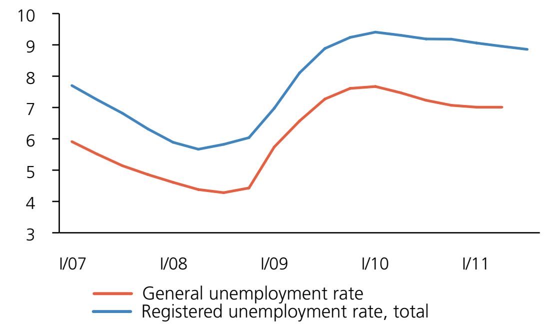


CHART III.4.4

BEVERIDGE CURVE

The number of vacancies remains low

(seasonally adjusted numbers in thousands)

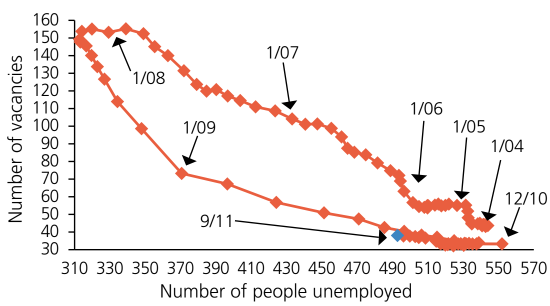


TABLE III.4.1

WAGES, PRODUCTIVITY, UNIT WAGE COSTS

Average wage growth accelerated

(annual percentage changes)

	III/10	IV/10	I/11	II/11
Average wage in Czech Republic				
nominal	1.9	0.6	2.1	2.5
real	0.0	-1.5	0.4	0.7
Average wage in business sector				
nominal	2.8	1.7	3.1	3.2
real	0.9	-0.4	1.4	1.4
Average wage in non-business sector				
nominal	-1.7	-3.9	-1.7	-0.9
real	-3.5	-5.9	-3.3	-2.7
Whole-economy labour productivity	2.4	2.9	2.4	1.7
Nominal unit wage costs	0.1	-1.5	-0.9	0.2

CHART III.4.5

WHOLE-ECONOMY PRODUCTIVITY

Whole-economy productivity growth slowed further in 2011 Q2
(annual percentage changes)

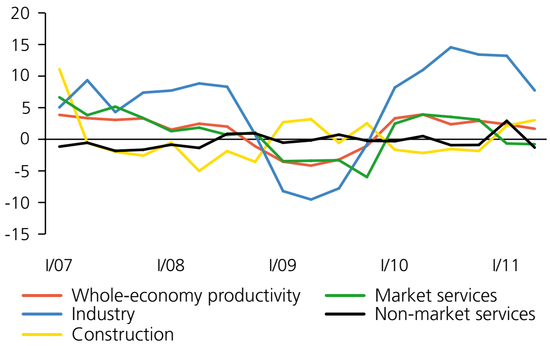
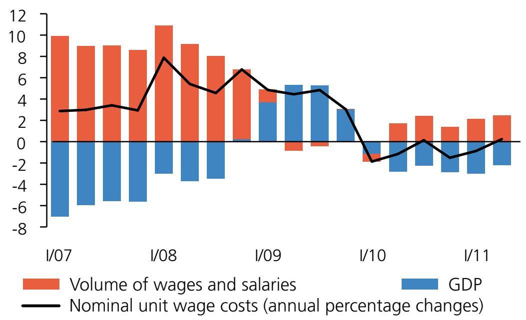


CHART III.4.6

NOMINAL UNIT WAGE COSTS

Nominal unit wage costs rose slightly in 2011 Q2
(contributions in percentage points; annual percentage changes)



uncertainty related to the future demand situation. Besides industry, wages grew in the majority of other branches of the business sector, with particularly strong year-on-year growth being recorded for real estate activities.

Annual **whole-economy labour productivity** growth slowed further to 1.7% in 2011 Q2 (see Chart III.4.5). This was due mainly to a noticeable slowdown of GDP growth accompanied by steadily rising employment. Major differences in productivity growth meanwhile continued to be observed across sectors (see Chart III.4.5). Again, the fastest growing was productivity in industry, though its year-on-year growth declined from double figures to 7.7% in Q2 amid slowing growth in industrial production and a further rise in employment.

In these circumstances, **nominal unit wage costs**[41] rose in 2011 Q2 (see Chart III.4.6). Year-on-year growth in nominal unit wage costs, which are an indicator of potential inflation pressures in the wage area, was only slight (0.2%). The main contributing factor was unit wage costs in market services, where a rising volume of wages and salaries outweighed growth in added value. In other sectors, the growth in nominal unit wage costs continued to decline year on year.

41 Nominal unit wage costs are calculated on the basis of non-seasonally adjusted data.

III.5 FINANCIAL AND MONETARY DEVELOPMENTS

Annual M2 and M3 growth remained subdued. The rate of growth of transaction money slowed further. After having picked up gradually, loan growth fell in non-financial corporations, probably as a result of worse expectations about the domestic economic situation linked with the escalation of the euro area debt crisis this summer. The volume of new loans for house purchase and the number of new mortgages both rose. Client interest rates on new loans and deposits were mostly falling slightly or little changed. Most financial indicators and key corporate performance indicators deteriorated. The household debt-to-income ratio rose further. The modest decline in prices of apartments continued.

III.5.1 Money

Following a slowdown in early 2011 and a subsequent slight pick-up, annual **M2** growth was flat at 3.1% in August (see Chart III.5.1). In Q2 the M2 growth rate converged towards the nominal GDP growth rate, causing the annual decline in the velocity of money to approach zero. M3 switched to growth in early Q3, reaching 0.9% in August.[42]

The long-running **decline in the velocity of broad money** had become more pronounced during the GDP growth decline in 2008 and the fall in GDP in 2009, but began to moderate as the economy recovered. A similar pattern as in the Czech Republic was observed in the euro area, the USA and the UK. The decomposition of the velocity of broad money shows that, while before 2008 the decline in velocity had been due significantly to monetary aggregate growth (primarily as a result of low interest rates and strong credit growth), after the global financial crisis escalated its path more strongly reflected changes in real GDP growth and the price level (see Chart III.5.2). The current trend indicates that the downswing in economic growth resulting from the escalation of the debt crisis is manifesting itself in a renewed slowdown in the velocity of money in the euro area and the USA amid a fading decline in the Czech Republic.

Turning to the **structure of M2**, growth in transaction money decreased further owing to slower growth in overnight deposits. The annual growth rate of M1 thus fell to 6.3% in August, whereas in the same period a year earlier transaction money had grown by about 15%. Within its structure, however, the growth rate of currency in circulation has been rising (to 3.1% this August compared to 0.4% in August 2010).[43] The opportunity cost of holding overnight deposits, as expressed by the spread between the interest rate on short-term deposits (i.e. deposits of up to two years and deposits of up to three months) and overnight deposits, increased marginally, but remains at

42 Annual M3 growth in the euro area rose to 2.8% in August 2011.

43 Currency in circulation increased by CZK 6 billion in the first eight months of 2011, while last year it fell by CZK 1 billion.

CHART III.5.1

MONETARY AGGREGATES

The broader money aggregates M2 and M3 continued to show subdued growth amid slowing growth in transaction money

(annual percentage changes)

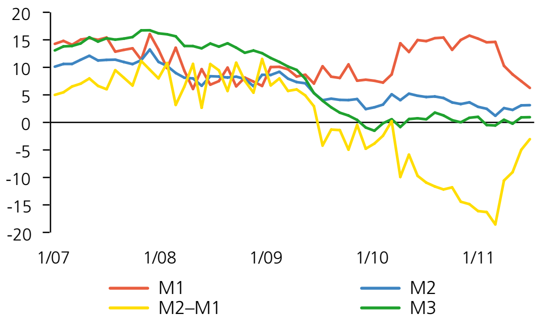
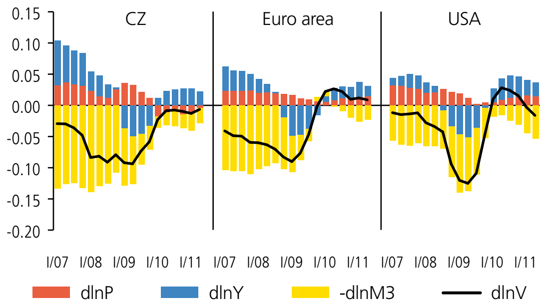


CHART III.5.2

DECOMPOSITION OF THE YEAR-ON-YEAR CHANGE IN THE VELOCITY OF MONEY IN THE CZECH REPUBLIC AND ABROAD

The changes in the velocity of money currently mainly reflect changes in economic activity and the price level

(seasonally adjusted data)



Note: *dlnV* = *dln P* + *dln Y* – *dln M3*, where *V* is the velocity of broad money, *P* is the price level measured by the GDP deflator, *Y* is real GDP, *M3* is a broad monetary aggregate (in the case of the USA M2 was used) and *ln* is the logarithm.

CHART III.5.3

MAIN COMPONENTS OF M2 AND THE INTEREST RATE SPREAD

Liquidity growth remains concentrated in overnight deposits

(annual flows in CZK billions; spreads in percentage points)

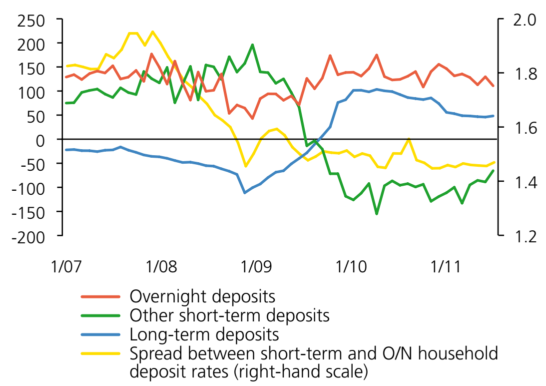
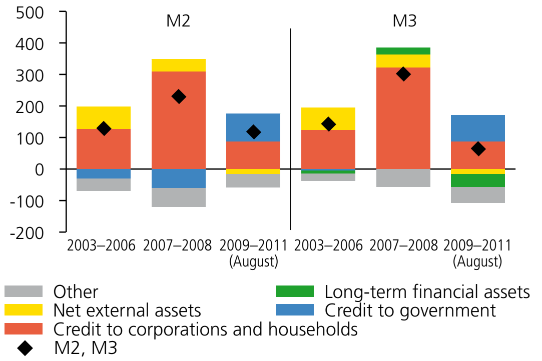


CHART III.5.4

MONEY SUPPLY FACTORS

The lower growth rates of the broad monetary aggregates reflect subdued credit growth and a decline in net external assets

(average annual flows in CZK billions)



Note: Long-term financial assets comprise time deposits with an agreed maturity of more than two years and redeemable at notice of more than three months as well as issued debt securities with maturity of more than two years.

CHART III.5.5

DEPOSIT STRUCTURE OF M2

Growth in households' bank deposits has been stabilised since 2010

(annual percentage changes)

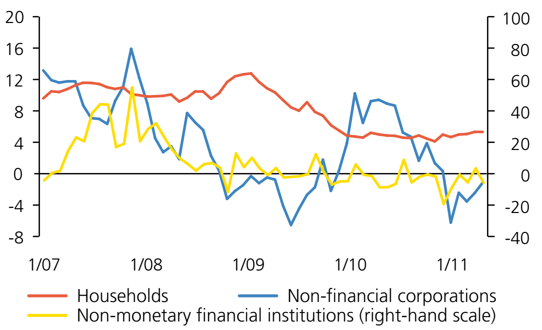
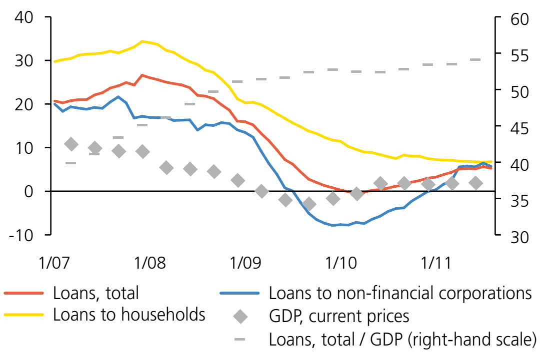


CHART III.5.6

LOANS TO CORPORATIONS AND HOUSEHOLDS

Growth in loans to the private sector decreased in August

(annual percentage changes; ratio in %)



a low level (see Chart III.5.3). The decline in other short-term deposits moderated. Demand for long-term deposits remained flat, reflecting their persistently low attractiveness.

Turning to **money supply factors**, the growth rate of credit to the private sector and government began to slow in 2011 Q3. Compared to the pre-crisis period, the growth rate of credit to the private sector is lower, while government financing is still elevated (see Chart III.5.4). The outflow of funds abroad, which until recently had been gradually weakening and which in H1 had manifested itself as slowing M2 growth, intensified in August. The growth of long-term financial assets, i.e. long-term time deposits and bank debt securities of over two years, manifested itself in lower M3 growth than M2 growth, as in the preceding months of this year.

Growth in bank client **deposits** has fallen to 0.3% year on year in recent months, while their ratio to loans has declined slightly to 133%. The annual growth rate of household deposits remained around 5%. The decline in the deposits of non-financial corporations moderated to 1% and deposits of non-monetary financial institutions fell by 5.8% (see Chart III.5.5).

III.5.2 Credit

Annual growth in **loans to the private sector** 2011 slowed noticeably in August for the first time since the beginning of the year, falling by 0.4 percentage point (compared to the previous month) to 5.3% (see Chart III.5.6). This reflected lower growth in corporate loans and a sharper decline in loans to non-monetary financial institutions, while the growth rate of loans to households was flat. In 2011 Q2, loans still recovered slightly and their ratio to GDP edged up to 54%. In the euro area, growth in loans to the private sector also slowed to 2.6% in August. Lower demand, particularly for corporate loans, accompanied by tighter credit standards, is expected in the euro area in 2011 Q4.

Annual growth in **loans to non-financial corporations** slackened by 0.8 percentage point to 5.7% in August. Both long-term and short-term loans contributed to the decline (see Chart III.5.7). As regards sectors, the lower credit growth was due primarily to loans to the trade, property development, construction and manufacturing sectors. Only growth in loans to the energy sector increased. The year-on-year decline in new corporate loans continued, while the growth of overdrafts and revolving loans moderated.

The lower borrowing by businesses seems to be due mainly to **demand factors** related to an expected moderation of growth in domestic economic activity resulting from the economic problems in the euro area, reflected in reduced confidence of domestic industrial companies. For the first time in a long time, insufficient demand began to manifest itself as the main barrier to growth in industrial output (see section III.3). On the other hand, the nominal and real costs associated with taking out short-term and long-term loans declined further to historical lows (0.6% for short-term loans and 1.3% for long-term loans in real ex ante terms).[44] According to a CNB survey, the availability of loans on the supply side over the last year was good (according to 79% of the businesses surveyed), while 71% of the businesses contacted expect no change in availability in the coming year.

Annual growth in loans to households was flat at 6.8%. Growth in **loans for house purchase** rose to 6.4%, while the growth rate of consumer and other loans (related mainly to loans to small businesses) moderated (see Chart III.5.8). Growth in the volume and number of new mortgage loans increased, amid a further decline in building society loans (see Chart III.5.9). According to Hypoindex, the volume of mortgage loans and the number of new mortgages both increased year on year in September 2011, albeit at a slower pace than in the previous month.

The current data show that banks' efforts to increase the supply of **mortgages**, supported mainly by low interest rates of major banking institutions and better availability of loans, are continuing. Growth of mortgage loans is expected to be fostered until the end of this year by the planned increases in VAT on construction work in 2012 and 2013. The risks to the mortgage market include a potential worsening of the future evolution of the domestic economy (see the alternative scenario in section II.4) and related slower household income growth. This could adversely affect the repayment of mortgage loans, especially among lower income households.

Turning to the **structure of new loans for house purchase** broken down by fixation period, the share of loans with floating rates or short fixations of up to one year decreased to 25% in August, of which the share of loans with three-month fixations dropped to 21% (see Chart III.5.10). Since 2010 the share of new loans with floating rates or short fixations has tended to grow. This share was influenced in 2010 and early 2011 by a sharp increase in the interest rate spread for longer and shorter fixations. Loans with rate fixations of one to five years still account for the largest share (54%) of total new loans for house purchase.

The annual growth rate of **consumer credit** slowed to 5.1%. The low willingness of households to borrow and to increase their consumption spending given the uncertain economic outlook continues to prevail on the consumer credit market. New consumer credit is still rising, but the monthly flows of such credit remain low. Consumer credit from non-bank institutions, i.e. hire-purchase and leasing companies, continued to decline year on year in 2011 Q2, albeit at a slower pace than in the previous period.

44 In nominal terms, interest rates stood at 3.5% for short-term corporate loans and at 4.1% for long-term loans.

CHART III.5.7

LOANS TO NON-FINANCIAL CORPORATIONS

Growth in loans to non-financial corporations slackened
(annual percentage changes; interest rates on outstanding amounts of loans in %)

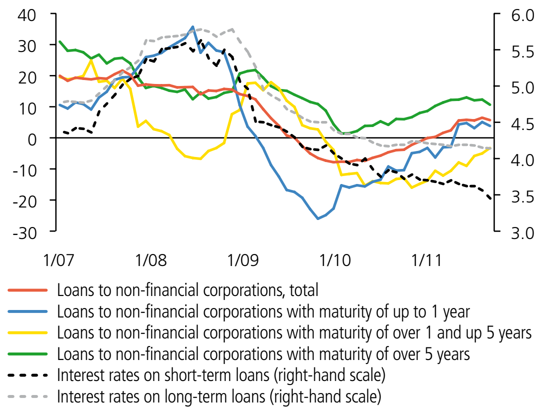
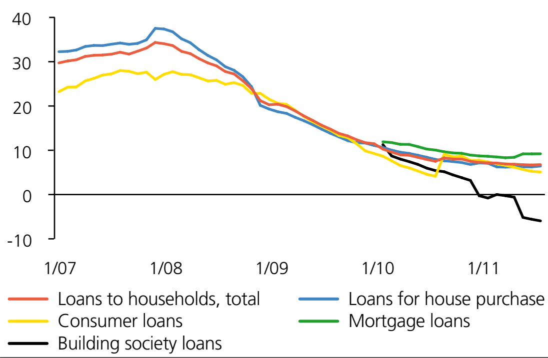


CHART III.5.8

LOANS TO HOUSEHOLDS

The rate of growth of loans to households was broadly unchanged
(annual percentage changes)



Note: Consumer loans have been affected since September 2010 by the merger of a bank with a non-bank institution (which was originally in the category of financial corporations engaged in lending).

CHART III.5.9

NEW LOANS FOR HOUSE PURCHASE

The rate of growth of new mortgage loans rose again after decreasing in July
(new business; contributions in percentage points; annual percentage changes)

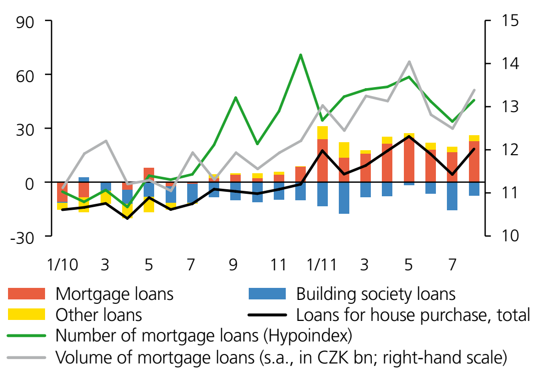
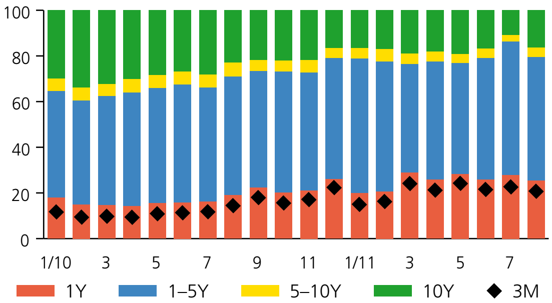


CHART III.5.10

STRUCTURE OF LOANS FOR HOUSE PURCHASE BY INTEREST RATE FIXATION

The share of loans with floating rates or rate fixations of up to one year fell in August, but has an upward long-term trend
(percentages)



Note: The share of loans with floating rates or rate fixations of up to three months is calculated as the share in total new loans and is included under loans with floating rates or rate fixations of up to one year.

CHART III.5.11

NON-PERFORMING LOANS OF CORPORATIONS AND HOUSEHOLDS

The decline in the share of corporate NPLs halted
(percentages; CZK billions)

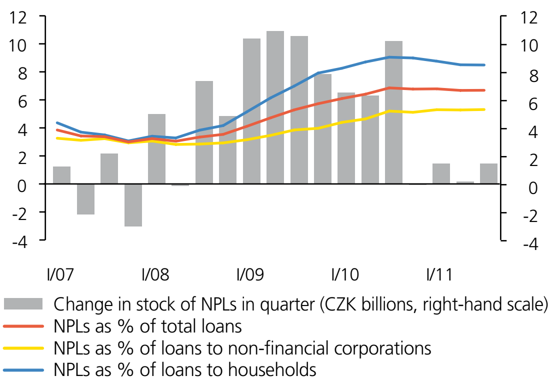
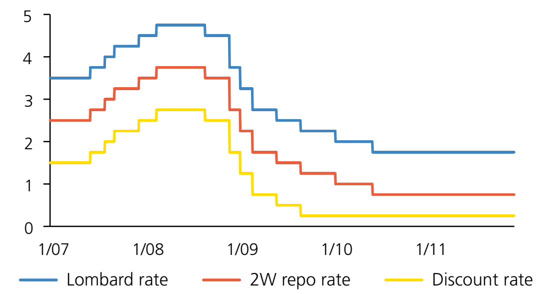


CHART III.5.12

CNB KEY RATES

The CNB left key rates unchanged in 2011 Q3
(percentages)



The ratio of **non-performing loans** to total loans of non-financial corporations rose in August for the first time in 2011 (by 0.2 percentage point to 8.5%; see Chart III.5.11). The volume of non-performing corporate loans also recorded year-on-year growth. The household NPL ratio remained at its highest level since 2005 (5.3%) in both the consumer credit segment (12.2%) and the house purchase loan segment (3.4%). The total volume of bank NPLs reached CZK 141 billion, compared to CZK 130 billion in the same period a year earlier.

III.5.3 Interest rates

Monetary policy interest rates

The monetary policy decision-making of the CNB Bank Board in 2011 Q3 was based on the macroeconomic forecast published in the previous Inflation Report. Consistent with the forecast and its assumptions was broad stability of market interest rates at the start of the forecast horizon and a gradual rise in rates starting in late 2011/early 2012. The risks of the previous forecast were assessed as being balanced at the Bank Board meeting in August. At the September meeting, the risks of the forecast were assessed as being moderate in the direction of lower inflation and strong in the direction of lower domestic interest rates. Accordingly, the Bank Board decided at both meetings to leave the **key interest rates** unchanged. The two-week repo rate was set at 0.75%, the discount rate at 0.25% and the Lombard rate at 1.75% with effect from 7 May 2010 (see Chart III.5.12).

At its monetary policy meeting on 3 November 2011, the Bank Board decided by a majority vote to **leave interest rates unchanged**. The risks of the new forecast were assessed as being significant and tilted towards interest rate stability in the spirit of the alternative, "euro area stagnation" scenario. The downside risks to inflation include slower wage growth and a significant deterioration in expected foreign economic growth, including a further decline in the outlook for world commodity prices and 3M EURIBOR rates. By contrast, fulfilment of the alternative, "euro area stagnation" scenario and a weaker exchange rate of the koruna would foster higher inflation (higher interest rates than in the baseline scenario).

Financial market interest rates

Money market interest rates were virtually unchanged in 2011 Q3, with the downward movements at individual maturities not exceeding 0.1 percentage point (see Chart III.5.13). **FRA derivative rates**, which have been declining gradually since early April and whose decline gained momentum during Q3, showed a more pronounced fall amid greater volatility. The rates thus responded to macroeconomic data suggesting an absence of demand-pull inflation pressures and slowing economic growth linked with developments abroad. In the euro area, in addition to the expected slackening of economic growth, the outlook for interest rates decreased significantly. Market expectations for domestic rates were revised above all at longer maturities. The current market outlook for 3M rates according to FRA quotations is slightly declining and is just above the path consistent with the baseline scenario of the new forecast (see sections I and II).

Interest rates with longer maturities also fell significantly during 2011 Q3 (by as much as 1 percentage point depending on maturity). Worries about a slowdown of the global economy, nervousness surrounding the Greek bail-out and concerns about the debt crisis in the euro area spreading further were the main factors on the financial market. Increased volatility was also apparent on foreign exchange, stock and commodity markets. Investors therefore preferred safe assets; in an environment of high risk aversion Czech government bonds were seen as attractive, especially after the Czech Republic's rating was upgraded (see Box 2).

The average **3M PRIBOR** was 1.2% in 2011 Q3 and was thus in line with the expectations of the previous forecast. Money market interest rates continued to be influenced by the credit premium. The average spread between the 3M PRIBOR and 2W repo rate was 0.43 percentage point in 2011 Q3. The spread has been very close to this level since May 2010.

Overall, PRIBOR interest rates have been almost unchanged since the start of 2011, while IRS interest rates have declined by as much as 0.9 percentage point at individual maturities and are thus at a historical low.

The **PRIBOR yield curve** barely changed during 2011 Q3 and its slope remained positive. The spread between the 1Y PRIBOR and 2W PRIBOR was around 0.9 percentage point in September 2011. The money market yield curve remained unchanged during October. By contrast, the **IRS yield curve** shifted to a lower level over its entire length and gradually became less steep. In September, the average 5Y–1Y spread was 0.5 percentage point and the 10Y–1Y spread 1.1 percentage points.

Short-term **interest rate differentials** vis-à-vis the two main world currencies (PRIBOR/CZK – EURIBOR/EUR, or LIBOR/USD) reflected developments on foreign markets amid flat rates on the domestic money market. The differentials vis-à-vis dollar rates rose slightly, while those vis-à-vis euro rates became slightly more negative (see Chart III.5.14). The 3M PRIBOR–3M EURIBOR interest rate differential was -0.4 percentage point on average in 2011 Q3 and recorded the same figure on 21 October.

Four auctions of fixed coupon bonds and three auctions of variable coupon bonds were held on the primary **government bond market** in the period under review. The total volume of bonds issued was CZK 50 billion. Demand strongly exceeded supply in almost all the

CHART III.5.13

MARKET INTEREST RATES

Money market interest rates were virtually unchanged, but IRS rates fell
(percentages)

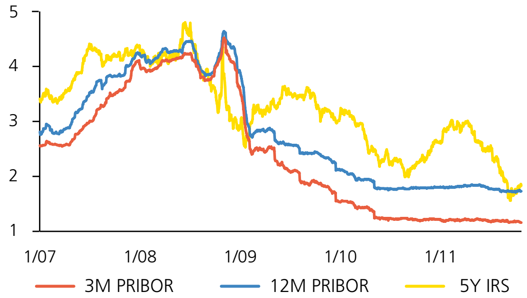


CHART III.5.14

INTEREST RATE DIFFERENTIALS

Interest rate differentials vis-à-vis the euro were in negative values
(percentage points)

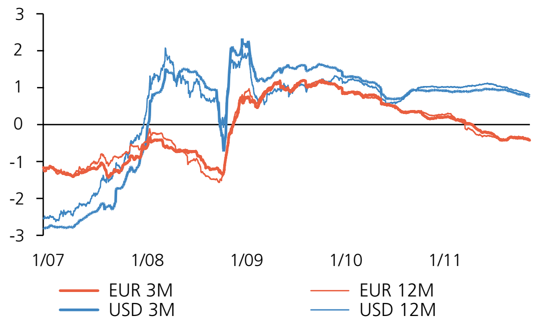
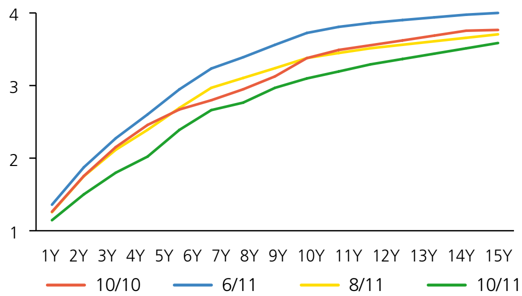


CHART III.5.15

GOVERNMENT BOND YIELD CURVE

The yield curve shifted downwards
(percentages)



auctions. The first-ever issue of "retail bonds" (intended primarily for households) also proved popular, with orders running to CZK 20.4 billion. The interest of institutional investors in standard government bonds focused mainly on variable coupon bonds and shorter-term bonds. This was closely linked with the decline in rates at longer maturities. The bonds were subscribed with lower yields than in the previous period. The government bond yield curve shifted downwards and its positive slope moderated somewhat (see Chart III.5.15).

Table 1 (Box)

RATING SCALE

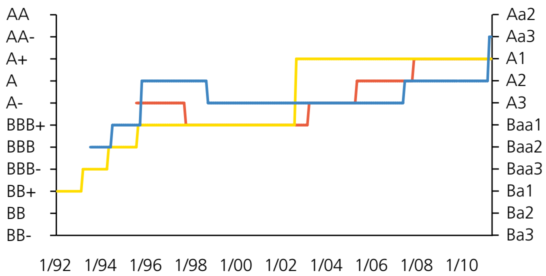
The rating scale is divided into grades ranging from the lowest speculative grade up to the highest investment grade
(source: Fitch, Standard and Poor's, Moody's)

Fitch	S&P	Moody's		Rating grade description (Moody's)
AAA	AAA	Aaa	Investment grade	Minimal credit risk
AA+ AA AA-	AA+ AA AA-	Aa1 Aa2 Aa3	Investment grade	Very low credit risk
A+ A A-	A+ A A-	A1 A2 A3	Investment grade	Low credit risk
BBB+ BBB BBB-	BBB+ BBB BBB-	Baa1 Baa2 Baa3	Investment grade	Moderate credit risk
BB+ BB BB-	BB+ BB BB-	Ba1 Ba2 Ba3	Speculative grade	Substantial credit risk
B+ B B-	B+ B B-	B1 B2 B3	Speculative grade	High credit risk
CCC+ CCC CCC-	CCC+ CCC CCC-	Caa1 Caa2 Caa3	Speculative grade	Very high credit risk
CC C	CC C	Ca	Speculative grade	In or near default, with possibility of recovery
DDD DD D	SD D	C	Speculative grade	In default, with little chance of recovery

Chart 1 (Box)

THE CZECH REPUBLIC'S RATING

The Czech Republic's rating has been improving steadily over time with the exception of the monetary turbulence in 1997–1998
(foreign currency long-term sovereign debt ratings; source: Fitch, Standard and Poor's, Moody's)



BOX 2
THE CREDIT RATING OF THE CZECH REPUBLIC

The sovereign credit rating evaluates a country's creditworthiness and its future ability to pay its obligations. Such ratings are produced by independent credit rating agencies, the best known being Standard and Poor's, Moody's and Fitch. The rating uses a scale ranging from the lowest speculative grade up to the highest investment grade (see Table 1). In addition to the rating, rating agencies typically release an outlook (positive, neutral or negative) that indicates future changes in the rating, along with a report giving the reasons. The sovereign credit rating serves as a basis for rating other issuers in the given country. Private issuers generally have lower ratings than the country.

The sovereign rating is based upon numerous quantitative and qualitative indicators, such as government debt and its evolution over time, the condition of, and outlook for, the economy, institutional development and political risks. The rating is a relative risk indicator and thus is not an exact measure of the likelihood of future default. However, rating agencies assess their success, i.e. the frequency of sovereign credit default for various rating grades, on an ex post basis.

The sovereign rating is important for investors in the securities of a given country or the securities of organisations subordinate to it. The higher is the rating, the lower should be the risk of sovereign default, and so the lower, generally, is the yield demanded on government bonds. The rating also serves as a measure of the country's economic development and its institutional and political stability. It is therefore also an important guide for investors wishing to invest in private businesses in the country.

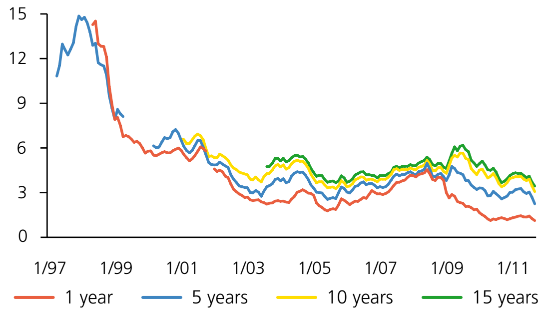
The first-ever credit rating of the Czech Republic (or rather the former Czechoslovakia) was issued in January 1992 through the rating of the former State Bank of Czechoslovakia, and reached the best speculative grade of Ba1. In March 1993, Moody's upgraded its rating to Baa3 and the Czech Republic thus became the first post-communist country to obtain an investment grade. Standard and Poor's and Fitch issued their first ratings to the Czech Republic in July 1994 (BBB) and August 1995 (A-) respectively. Except for the period of monetary turbulence between 1997 and 1998, the Czech Republic's rating has steadily improved throughout its history (see Chart 1). The latest upgrade occurred this August, when Standard and Poor's increased the Czech Republic's rating by two grades to AA-. Estonia, Japan and Saudi Arabia have the same rating.

The improving rating, coupled with inflation declining to low levels, has fostered a downward trend in yields on Czech government bonds. The yields have been falling steadily at all maturities over the past 15 years, except for the period of monetary turbulence and at the start of the financial crisis in 2007–2008 (see Chart 2), and are currently at historical lows.

CHART 2 (BOX)

THE CZECH REPUBLIC'S BOND YIELDS

Government bond yields have been falling steadily at all maturities and are currently at historical lows
(yields in % p.a.; CNB calculation; data source: Prague Stock Exchange)



Client interest rates

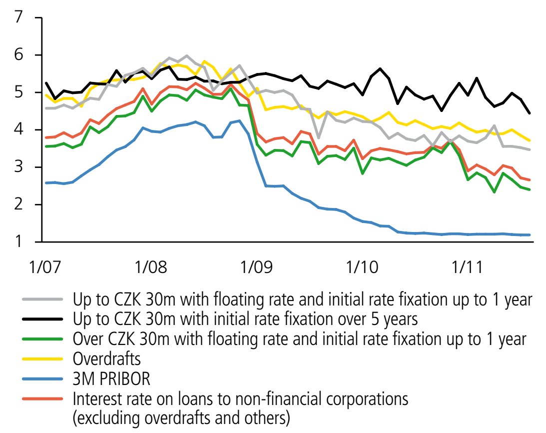
Interest rates on new loans and deposits have mostly been flat or falling moderately so far in 2011 Q3, amid continuing flat money market rates and a declining ten-year government bond yield. By contrast, rates rose in the case of loans to small business, overdrafts, and deposits of households with agreed maturity. Client risk premia continued to fall with respect to rates on large corporate loans and loans for house purchase with short fixations of up to one year. By contrast, credit standards were tightening in the euro area in 2011 Q3 (see the ECB Monthly Bulletin, October 2011, Box 3).

The **interest rate on loans to non-financial corporations** recorded a further decline, the rate on small loans (up to CZK 30 million) falling to 3.6% and that on large loans to 2.4%. It is thus at its lowest level since 2004 (see Chart III.5.16). Loans with floating rates and rates fixed for up to one year, which account for 98% of loans to corporations, dropped by between 0.1 and 0.3 percentage point. This reflected flat money market rates and a decline in risk premia on large loans. In the euro area, interest rates on corporate loans also remain at low levels of 3–5%.

CHART III.5.16

INTEREST RATES ON LOANS TO CORPORATIONS

Interest rates on corporate loans declined slightly further
(new business; percentages)



Turning to households, the **interest rate on loans for house purchase** was flat at 4.4% (see Chart III.5.17). In particular, the rate on loans with floating rates or rates fixed for up to one year declined slightly, although the same trend was also apparent for other rate fixations in August (see Chart III.5.18). The rate on loans with floating rates or rates fixed for up to three months also edged down (to 3.8%). According to Hypoindex, interest rates on mortgages fell again in September 2011 (to 3.9%). The path of interest rates with short fixations reflected flat money market rates and lower client risk premia on those fixations. However, the long-running decline in the

CHART III.5.17

CHANGES IN INTEREST RATE ON LOANS FOR HOUSE PURCHASE

The interest rate on loans for house purchase remains low, mainly because of mortgage loan rates
(new business; monthly changes in percentage points; interest rate in %)

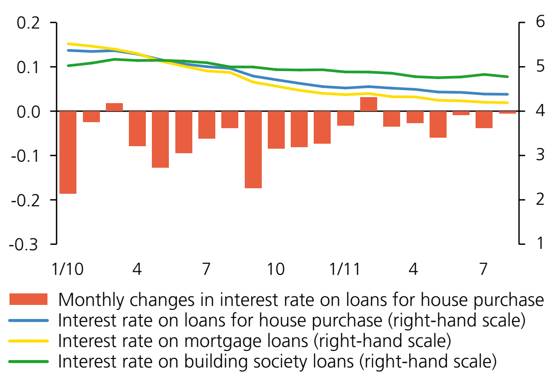


Chart III.5.18

INTEREST RATES ON LOANS FOR HOUSE PURCHASE

The interest rate on loans with fixations of up to 3 months fell slightly in Q3
(new business; percentages)

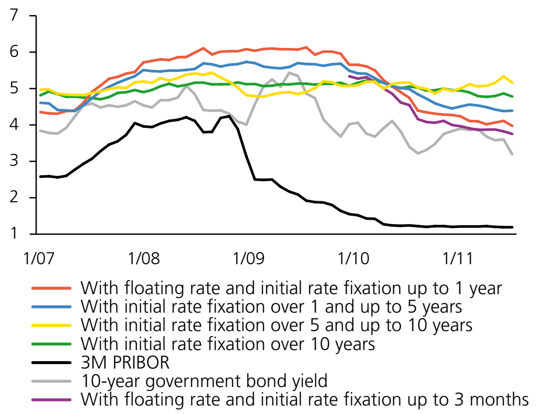


Chart III.5.19

CLIENT AND MARKET INTEREST RATE SPREADS

Banks reduced slightly further the spreads between client and market rates on house purchase loans with short fixations and on large corporate loans
(percentage points)

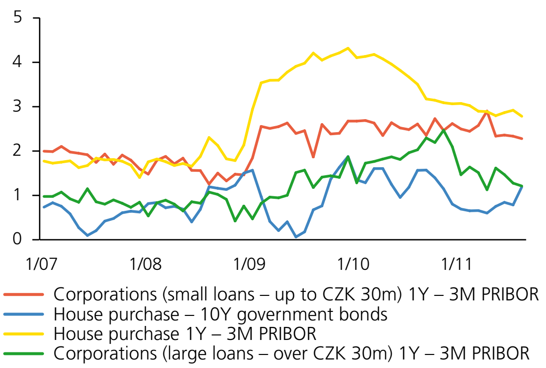
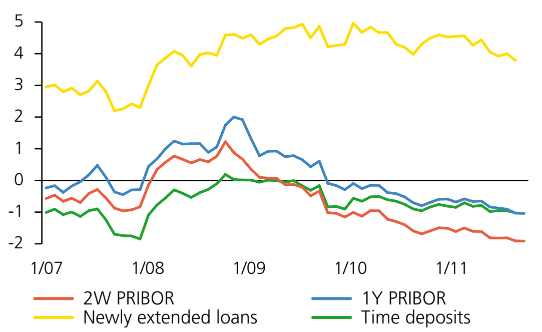


Chart III.5.20

EX ANTE REAL RATES

Ex ante real interest rates on new loans declined in 2011 Q3
(percentages)



spread between the rate on house purchase loans with floating rates or short fixations and the 3M PRIBOR market rate gradually decreased in Q3. On the other hand, the spread between the overall rate on loans for house purchase and the ten-year government bond yield increased as a result of a decrease in the government bond yield (see Chart III.5.19). Rates on house purchase loans remain low across all fixation periods. In the euro area these rates rose slightly on short fixations, while other rates declined slightly or were flat within the range of 3–4%.

The **interest rate on consumer credit** remains high at 13.8%. The rate on current account overdrafts did not change substantially in the period under review (15.4%), while the credit card rate fell further to 20.3%. After declining in 2010, the spread between the rate on consumer credit and the 3M PRIBOR market rate was broadly flat in 2011 H1. Compared to the euro area, the said rates remain higher. In the euro area, the rates on consumer credit range between 5% and 8%, while rates on overdrafts and credit cards are 8% and 17% respectively.

Interest rates on deposits did not change during Q3, except for the household deposit rate with an agreed maturity of up to one year, which rose. This rate had been declining between 2008 and 2010, but several large banks began to increase it this year.[45] The interest rates on overnight deposits for households and on deposits redeemable at notice are 0.7% and 2% respectively. After a previous decline, the rates on corporate deposits have stabilised this year at a lower level, averaging 0.4%.

Real client interest rates[46] mostly declined in Q3. Real rates on new loans were 3.8% in August, while real rates on time deposits were -1.0% (see Chart III.5.20).

III.5.4 The exchange rate

The average **exchange rate of the koruna against the euro** was CZK 24.4 in 2011 Q3. In year-on-year terms the koruna appreciated by 2%, while compared to the previous quarter it depreciated slightly. Between February and mid-September the exchange rate was fluctuating between CZK 24.0 and 24.6 to the euro, but since the end of September it has been depreciating (see Chart III.5.21). In the second half of October the koruna's exchange rate has so far been fluctuating between CZK 24.7 and 25.0 against the euro.

45 The rate on these deposits was about 3% in the pre-crisis period, but subsequently fell to 0.9% at the close of 2010 and rose again this year to 1.6% in August.
46 Ex ante real interest rates: nominal interest rates are deflated by the consumer price inflation expected by financial market analysts.

The debt crisis in the euro area significantly affected the financial markets again in 2011 Q3. The growing uncertainty was reflected in depreciation of some central European currencies. However, the koruna fluctuated without any significant trend thanks to its position as a relatively safe currency. At the end of August the koruna firmed temporarily to CZK 24.10 against the euro when S&P upgraded the Czech Republic's long-term foreign currency rating by two grades from A to AA-. At the end of September the markets showed interest in the dollar as a safe currency and the koruna began to depreciate. The koruna did not respond to domestic developments, merely depreciating briefly after the current account data were released.

The average **exchange rate of the koruna against the dollar** was CZK 17.3 in 2011 Q3, which represents a year-on-year appreciation of 11% and a quarter-on-quarter depreciation of 2%. Until the end of August the koruna-dollar exchange rate displayed no significant trend and hovered around CZK 17.0 to the dollar. However, the continuing debt crisis in the euro area with no signs of a clear resolution renewed investors' interest in the dollar in early September and the koruna began to depreciate against the dollar. In October it weakened to CZK 18.9, i.e. to its January 2011 level.

III.5.5 Economic results of non-financial corporations

In the monitored segment of **non-financial corporations with 50 employees or more**[47] the annual growth of the main monitored indicators slowed in 2011 Q2. Sales and output continued to record relatively fast annual growth, but were still accompanied by sizeable growth in intermediate consumption, which fostered a marked slowdown in book value added. According to CNB calculations, annual growth in gross operating surplus also slowed sharply, affected by modestly accelerating growth in personnel costs (see Chart III.5.22).

Against a background of a rising **material cost-output ratio** of non-financial corporations, the buoyant growth in import prices of energy and non-energy commodities and metal-based semi-finished products continued into 2011 Q2. Corporate costs were also affected by renewed growth in prices of energy of domestic origin at the start of this year. Owing to the above factors, the material cost-output ratio of non-financial corporations rose again in annual terms (by 1 percentage point; see Table III.5.1), although its growth was slightly lower than in the previous quarter.

The **wage cost-output ratio** of non-financial corporations continued to fall year on year in 2011 Q2 (see Table III.5.1), as personnel costs continued to rise more slowly than output, even though the output growth rate moderated compared to the previous quarter. The year-

47 The segment of corporations with 50 employees or more consisted of almost 9,400 non-financial corporations at the end of 2011 Q2.

Chart III.5.21

CZK/EUR AND CZK/USD EXCHANGE RATES

The koruna was flat in 2011 Q3, but depreciated in October

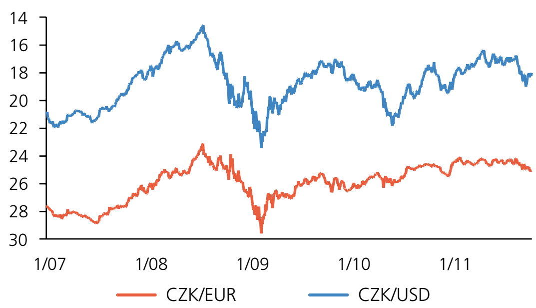


Chart III.5.22

KEY FINANCIAL INDICATORS

The key financial indicators recorded slower year-on-year growth in 2011 Q2

(annual percentage changes)

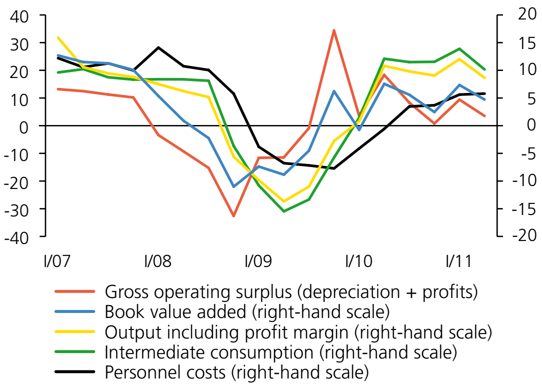


Table III.5.1

PERFORMANCE INDICATORS OF CORPORATIONS

The year-on-year growth in the material cost-output ratio and the decline in the wage cost-output ratio continued into 2011 Q2

(annual percentage changes)

	2010 Q2	2011 Q2	Annual percentage changes
Output incl. profit margin (CZK billions)[a)]	1,291.1	1,402.7	8.6
Personnel costs (CZK billions)	188.7	199.6	5.8
Intermediate consumption (CZK billions)	932.8	1,027.5	10.2
Book value added (CZK billions)	358.3	375.2	4.7
Sales (CZK billions)	1,662.9	1,801.6	8.3
	Percentages	Percentages	Annual changes in p.p.
Ratio of personnel costs to value added[a)]	52.7	53.2	0.5
Material cost-output ratio[a)]	72.2	73.3	1.0
Personnel cost-output ratio[a)]	14.6	14.2	-0.4
Ratio of book value added to output[a)]	27.8	26.7	-1.0

a) CNB calculation

CHART III.5.23

FINANCING OF NON-FINANCIAL CORPORATIONS

Growth in the financial liabilities of corporations decreased

(contributions to external financing in percentage points; annual percentage changes)

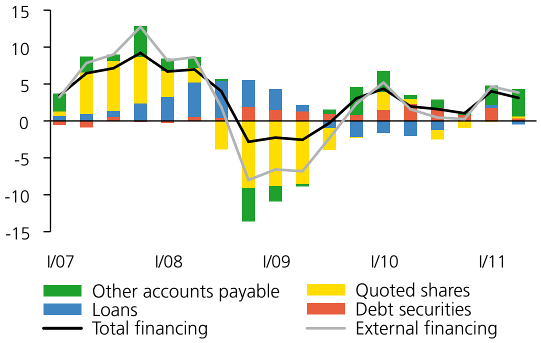
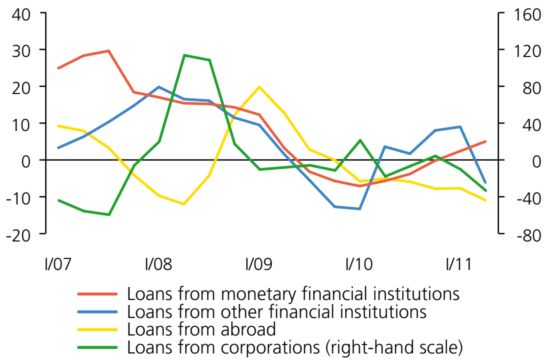


CHART III.5.24

DOMESTIC AND FOREIGN CORPORATE LOANS

Domestic bank loans were alone in recording slight growth

(annual percentage changes)



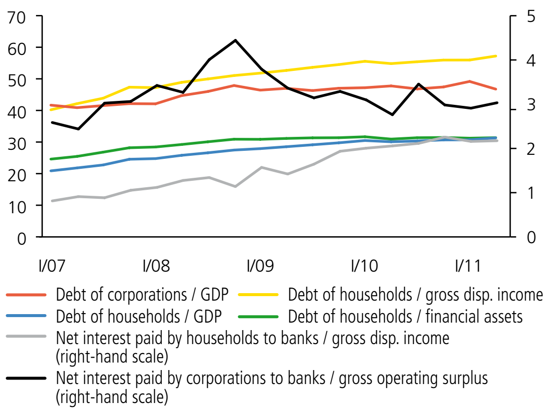
Note: The time series of loans from other financial institutions were revised in 2011 owing to a change in methodology.

CHART III.5.25

DEBT AND NET INTEREST PAYMENTS

The ratio of corporate debt to GDP fell, while the ratio of household debt to income increased further

(percentages)



on-year decline in the wage cost-output ratio reached -0.4 percentage point in Q2 and was more moderate than in the previous quarter.

Data for the narrower **segment of large corporations** (with 250 employees or more[48]) indicate that while the output of these corporations continued to grow somewhat faster than in the wider segment of corporations, their book value added slowed more sharply and, according CNB calculations, their gross operating surplus in fact declined slightly in annual terms.

III.5.6 Financial position of corporations and households

In 2011 Q2, most financial indicators were pointing to a **deterioration in corporate profitability** and slower growth in **external financing**. Annual growth of external financing of corporations fell to 3.8% (see Chart II.5.23).[49] Within its structure, growth in debt securities declined and, after a previous upswing, loans began to fall again. By contrast, other accounts payable (connected, among other things, with trade liabilities) and issuance of quoted shares rose year on year, although in both cases mainly due to base effects. The share of market financing of corporations via securities in external financing declined to 20.6%. **Total corporate financing**, which includes shareholders' equity in the form of unquoted shares and other equity in addition to external financing, also rose more slowly in 2011 Q2 than in the preceding period (by 3.1%).

Loans from non-bank institutions, foreign loans and loans from other domestic corporations contributed to a decline in **total loans** to non-financial corporations. By contrast, loans obtained from domestic banks grew in Q2. However, the latest available monthly data for Q3 indicate a potential slowdown in this segment of the credit market as well (see Chart III.5.24). The ratio of debt financing of corporations in the form of loans, debt securities issued and other accounts payable to equity decreased to 100% as a result of a decline in debt financing.

Annual growth in **financial investment by corporations** declined to 3% in 2011 Q2. Corporations invested less in debt securities and shares, while the contribution of currency and deposits decreased. The share of financial investment by corporations in total financial investment in the economy decreased to 22.7%.[50]

The ratio of the **debt of non-financial corporations** (loans and debt securities issued) to GDP reached 46.7%[51] in 2011 Q2 and declined

48 The segment of corporations with 250 employees or more consisted of almost 1,700 non-financial corporations at the end of 2011 Q2.

49 The post-2004 data were revised upon the publication of the financial accounts data for 2011 Q2. External financing comprises loans, debt securities, quoted shares and other accounts payable. Total financing comprises all financial liabilities of corporations.

50 Non-financial corporations account for 23%, households 18%, financial institutions 31%, general government 8% and rest of the world 20% of financial investment in the economy as a whole.

51 When other accounts payable (relating mainly to trade liabilities) are included, the ratio of corporate debt to GDP is 112.2%.

compared to the previous quarter. This ratio remains relatively low by international comparison. After declining in 2008 and 2009, the net interest burden on corporations resulting from bank loans relative to gross operating surplus has been fluctuating around 3% since 2010. Its evolution continued to reflect mainly the decline in interest rates (see Chart III.5.25).

The **financial indicators of non-financial corporations** point to a slight decrease in solvency. By contrast, the acid-test ratio of corporations increased year on year, owing mainly to a decline in short-term financial liabilities. In the longer term, the solvency of corporations is roughly at the end-2008 level, while the acid-test ratio is substantially higher than in the pre-crisis period as a result of lower corporate indebtedness. Leverage rose slightly in Q2 in year-on-year terms (see Table III.5.2).

The difference between corporations' **internal funds** (gross savings, i.e. profit and depreciation) and their investment expenditure (i.e. gross capital formation) turned negative in Q2, mainly because of a decline in gross savings. On the basis of annual flows, corporations continued to finance their economic activity mostly from internal funds, while the use of external financing was lower. The ratio of gross savings to gross value added was 26.6% on the basis of annual flows, while for financial liabilities the figure was 11.6% (20.1% for fixed investment and 6.2% for financial assets).

The annual growth rate of overall financing of households by banks and non-bank institutions increased to 5.6% in 2011 Q2 (see Chart III.5.26). The ratio of **household debt** to gross disposable income rose to 57.2% amid a further weakening of growth in gross disposable income. By comparison, the debt-to-GDP ratio recorded a smaller increase of 31.3%. By contrast, the ratio of household debt to financial assets, following a rise, has been showing signs of stabilisation since 2010 (in 2010 the ratio was 35% with respect to financial assets and 15% as regards total assets). At the same time, the interest burden on households was little changed at 2.2% relative to income (see Chart III.5.25). Compared to the pre-crisis period, the solvency of households (as measured by the ratio of financial assets to liabilities) remains subdued, while the acid-test ratio (as measured by the ratio of selected short-term financial assets to short-term loans) has been rising since 2008 due to a decline in short-term loans. The debt of Czech households in relation to GDP is about one half compared to the euro area, while the ratio of their total assets to GDP amounts to one third of the euro area level.

Growth in **financial investment by households** also picked up slightly in 2011 Q2 (to 4.4%). This reflected stronger growth of investment in securities and shares against the background of stagnating financial investment in currency in circulation and deposits. Compared to the previous quarter, year-on-year growth in the ratio of net financial assets to total annual gross disposable income rose as a result of stronger growth of financial liabilities than of assets.

TABLE III.5.2

FINANCIAL INDICATORS OF CORPORATIONS

Corporate solvency decreased slightly

	IV/10	I/11	II/11	II/11
Corporations, total [a]	Annual percentage changes			CZK billions
Equity (shares and other equity issued)	-5.8	-0.7	2.1	4,112.7
Loans	-0.2	1.5	-1.5	1,428.5
Debt securities	15.8	34.4	4.9	301.5
Quoted shares	-5.8	-0.7	2.1	695.7
Other accounts payable	0.7	5.3	7.6	2,423.6
Total financing[1]	1.0	4.0	3.1	8,266.3
Financial assets	2.4	5.8	3.0	4,635.9
Corporations, total [a]	Annual changes in percentage points			Indicators in %
Acid-test ratio[2]	13.8	8.7	4.7	153.8
Solvency indicator[3]	1.3	0.2	-1.2	111.6
Financial leverage[4]	1.8	3.6	1.0	112.7

a) CNB calculation
1) Total financial liabilities
2) Short-term fin. assets / short-term fin. liabilities (debt securities issued and loans)
3) Total financial assets / liabilities excluding shares and other equity
4) Total financial assets / shares and other equity issued

CHART III.5.26

FINANCING OF HOUSEHOLDS

The rate of growth of household debt increased

(contributions in percentage points; annual percentage changes)

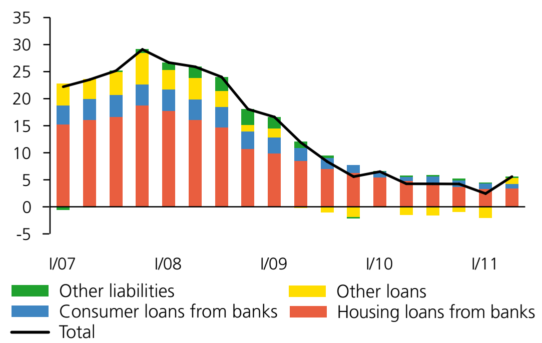
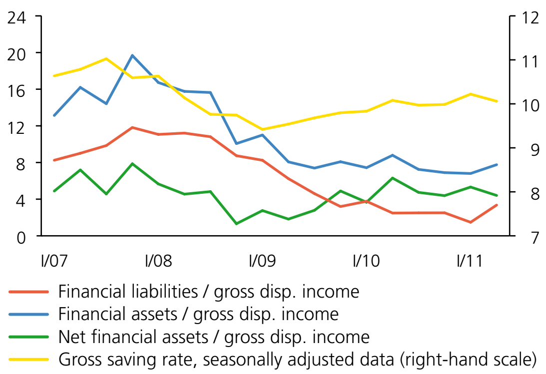


CHART III.5.27

HOUSEHOLDS' NET FINANCIAL ASSETS AND GROSS SAVING RATE

Growth in the ratio of net financial assets to gross disposable income slowed slightly

(annual percentage changes calculated from annual flows; ratios in percentages)



This also corresponded to a slight decline in the gross saving rate of households (see Chart III.5.27). However, the ratio of financial liabilities to income remains substantially lower than in the pre-crisis period.

III.5.7 The property market

Asking prices of apartments continued to decline moderately in 2011 Q3. According to CZSO data, the quarterly decline reached 0.4% in Prague and 0.8% in the rest of the Czech Republic. In year-on-year terms, the decline deepened slightly (by 0.4 percentage point) in the rest of the Czech Republic, but in Prague, by contrast, it moderated by 0.4 percentage point (see Chart III.5.28). As regards **transaction prices of apartments**, for which new CZSO estimates based on surveys in real estate agencies are available for Q2,[52] their year-on-year declines are moderating especially in Prague; in fact, an annual rise of 1.7% was recorded for older apartments and prices of new apartments fell by only 0.6%. However, prices of older apartments are falling year on year in the rest of the Czech Republic (down by 3.9%). The slightly smaller decline in transaction prices compared to asking prices, which had also been apparent in 2010 H2 (see Chart III.5.28), may indicate that the situation on the residential property market is stabilising, as transaction prices usually respond to changes in conditions with a lag.

In addition to the decline in apartment prices, the **number of property market transactions** continued to fall in 2011 Q3. The number of proceedings on entry of ownership rights in the cadastre fell by 11.4% year on year in 2011 Q3 and the one-year moving sum of the number of transactions decreased by 2.8% quarter on quarter (see Chart III.5.29).

By contrast, the number of new **mortgage loans** for house purchase continued to rise in 2011 Q3 (see Chart III.5.2), increasing by 6.9% quarter on quarter (one-year moving sum) to a level almost 50% higher than in mid-2010 (Fincentrum Hypoindex data; see Chart III.5.29). Although the recovery in mortgage growth is connected with declines in building society loans (substitution between these two types of loans) and a part of the increase can be attributed to refinancing of existing mortgages, it may indicate a recovery in property market demand, as the allocation of a mortgage usually precedes the property transaction itself and may thus be viewed as a leading indicator of the number of transactions.

CHART III.5.28

TRANSACTION AND ASKING PRICES OF APARTMENTS

The year-on-year decline in asking prices of apartments continued into 2011 Q3

(annual percentage changes; source: CZSO, Institute for Regional Information)

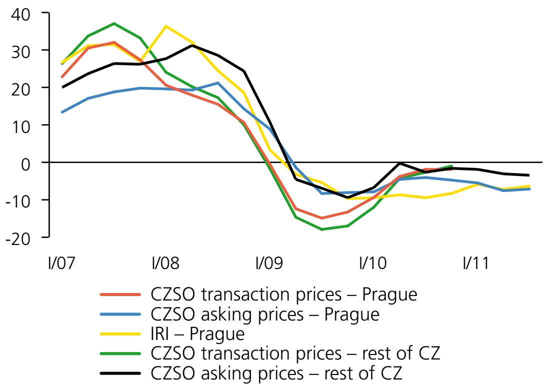
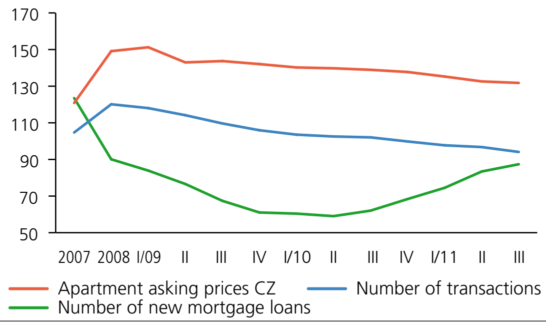


CHART III.5.29

NUMBERS OF TRANSACTIONS IN THE PROPERTY MARKET

The decline in prices was accompanied by a continuing fall in the number of transactions in the property market

(2006 average = 100; numbers of transactions as moving sums for 1 year; source: CZSO, COSMC, Fincentrum Hypoindex)



52 This index differs from the transaction price index published by the CZSO (based on prices from property transfer tax returns), which is the source of data for Chart III.5.28. The advantages of the new alternative index are that it has a shorter publication lag and also that it covers prices of new apartments, which are not subject to property transfer tax. On the other hand, this index does not cover property transactions outside estate agencies, its structure is less detailed and its time series is shorter.

A temporary rise in new supply is visible in the CZSO data on housing completions, which rose by 6% year on year in June–August 2011 following previous marked declines. This was due mainly to a rise in housing completions in apartment blocks, which reached 38.5%. However, housing starts continued to decrease (falling by 9.5% in June–August and by 37.1% for apartment blocks).

The property price sustainability indicators decreased in 2011 Q3. The **price-to-income ratio** fell by 1.4% and the **price-to-rent ratio** by 2.2% quarter on quarter. Both indicators are close to their lowest levels since the end of 2007 (see Chart III.5.30) and are now down quite considerably (by 28.9% and 9.8% respectively) from their highs recorded at the end of 2008 Q3. Consequently, these two indicators do not suggest a risk of property price overvaluation.

Despite some positive signals on the property market, we continue to expect – on the basis of labour market developments (see section III.4) and demographic developments[53] – that apartment prices will stagnate in the rest of 2011 and early 2012 and gradually recover during 2012. By contrast, the risks to property prices are largely on the downside given the possible slowdown in economic growth abroad as well as continuing rent deregulation, which could lead to downward pressures on market rents and growth in the price-to-rent ratio. Lower prices could also be fostered by a one-off rise in the supply of apartments due to foreclosures of apartments or apartment blocks.

Take-up in the **commercial property sector** continued to recover. In the first three quarters of 2011, gross take-up in the office property segment increased by 8% year on year. The share of renegotiations in gross take-up fell from 42% in 2010 to 31% so far in 2011 (Jones Lang LaSalle data). Take-up of retail property is also rising, and take-up in the industrial segment remains stable at a relatively high level. In the office property segment, new office space construction started to recover after a relatively long decline,[54] but the vacancy rate is still decreasing (by 1.4 percentage point year on year to 11.8%) as in the case of other types of commercial property.[55] A recovery in take-up is also indicated by a decline in commercial property yields in all market segments (down by 0.5 percentage point year on year; see Chart III.5.31; as rents are relatively stable, yields are negatively correlated with prices).

53 In particular a gradual decline in natural population growth and in population growth due to migration.
54 New supply reached 47,980 sq. m in 2011 Q3, the highest figure since 2009 Q4.
55 A marked year-on-year decrease in the vacancy rate for industrial property of 7.2 percentage points was recorded in 2011 Q2.

CHART III.5.30

APARTMENT PRICE SUSTAINABILITY INDICATORS

The apartment price-to-income and price-to-rent ratios continued to fall
(2000–2007 average = 100)

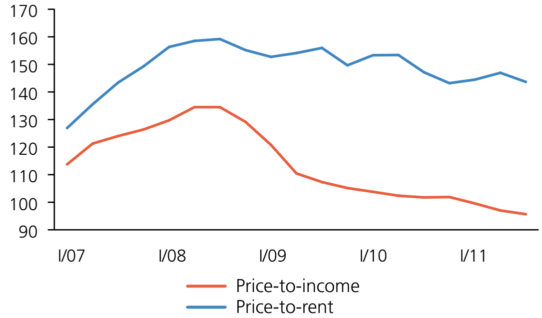


CHART III.5.31

OFFICE PROPERTY YIELDS

Commercial property yields are falling moderately
(percentages; source: Jones Lang LaSalle, Prague Research Forum)

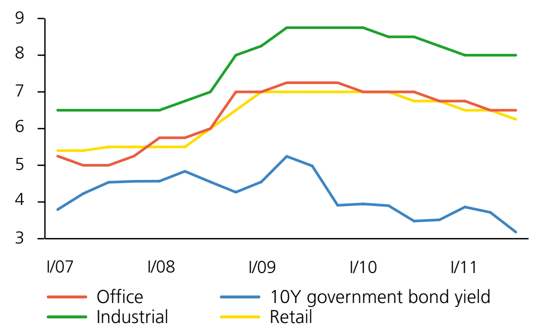


CHART III.6.1

CURRENT ACCOUNT

The current account deficit increased in 2011 Q2, owing mainly to a rising income deficit
(annual moving totals in CZK billions)

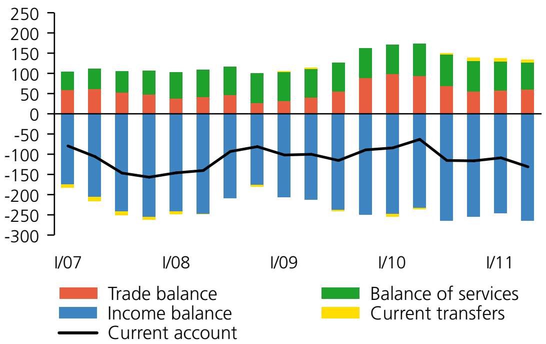


CHART III.6.2

TRADE BALANCE

The year-on-year change in the trade balance was affected most strongly in 2011 H1 by growth in the machinery surplus
(accumulation since start of year in CZK billions)

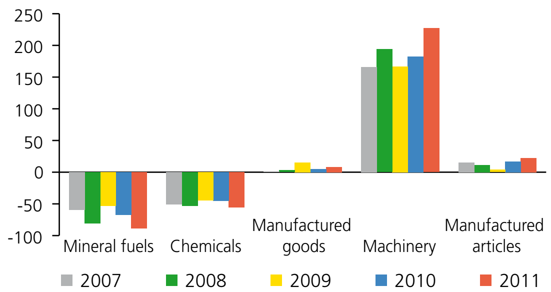
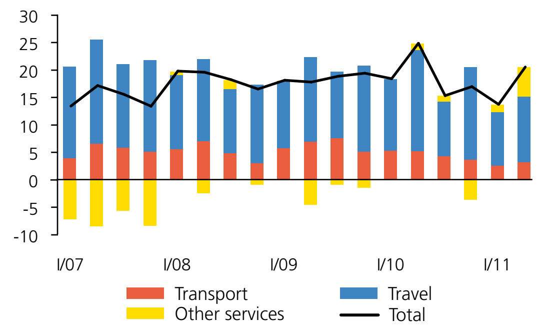


CHART III.6.3

BALANCE OF SERVICES

All three sub-balances contributed to the services surplus in 2011 H1
(CZK billions)



III.6 BALANCE OF PAYMENTS

In 2011 H1, the balance of payments was characterised by a high income deficit, due mainly to direct investment income. However, its effect on the current account was partly offset by a surplus on goods and services. The financial account surplus was driven mainly by a net inflow of direct investment due to earnings reinvested in the Czech Republic, as well as by a surplus on other investment. However, it was partly offset by a net portfolio investment outflow as a result of purchases of foreign securities by residents.

III.6.1 The current account

The **current account** ended 2011 H1[56] in a deficit of CZK 28.4 billion. In year-on-year terms, the deficit increased by almost CZK 15 billion. The rise in the overall deficit was related above all to income balance and services balance developments (see Chart III.6.1). The ratio of the annual moving current account deficit to GDP increased to 3.5%.

The half-year **trade surplus** rose by CZK 5 billion year on year to CZK 59 billion. The increase in the trade surplus was due to developments in real terms, which were, however, largely offset by the price effect associated with a negative annual change in the terms of trade. Strong growth in external demand (especially in Q1) was reflected in continuing rapid goods export growth, whose nominal year-on-year rate exceeded 15% despite appreciation of the exchange rate of the koruna. Goods imports increased at a similar nominal pace as a result of the traditionally high import intensity of exports and high energy commodity prices. However, the acceleration of imports was hindered by muted growth in total domestic demand. Turning to the commodity structure, growth in the machinery and transport equipment surplus was the biggest contributor to the increase in the overall surplus. By contrast, an increase in the deficit on mineral fuels was the strongest factor acting in the opposite direction (see Chart III.6.2). The year-on-year rise in the trade surplus continued into 2011 Q3, with the trade balance rising by CZK 8 billion in July–August.

The **balance of services** also ended in a surplus in 2011 H1 (CZK 34.2 billion). However, it recorded a year-on-year decline of CZK 9 billion (see Chart III.6.3). All three sub-balances, especially travel, contributed to the overall surplus. Travel was also the biggest contributor to the year-on-year decline in the overall surplus owing

56 Revised data for 2005 onwards were published together with the balance of payments data for 2011 Q2. The revisions related mainly to current account items, especially the trade balance in connection with the completion of its adjustment for branding (margin payments due to non-residents). The largest changes are apparent for 2007 and 2008, when the current account deficit and its ratio to GDP increased (by 1.2 percentage points to 4.4% in 2007 and by 1.6 percentage points to 2.2% in 2008). In the other years, by contrast, the current account deficit has been reduced by the revisions.

to a decrease in credits and an increase in debits. The decline in the surplus on transport services was more moderate and was offset by a rise in the other services surplus.

In contrast to the goods and services surplus, the **income balance** ended in a half-year deficit of CZK 130 billion, up by almost CZK 10 billion year on year. The balance of direct investment income (CZK -128.9 billion) had the largest impact on the overall deficit. It was affected by dividends paid to non-residents and by earnings reinvested in the Czech Republic (see Chart III.6.4). The annual widening of the overall deficit was also linked mainly with the growth in the direct investment income deficit due to higher dividends paid to non-residents. On the other hand, a lower portfolio investment income deficit due to higher credits fostered an annual moderation of the overall deficit, albeit to a lesser extent.

Current transfers recorded a surplus of CZK 8.4 billion in H1, down by CZK 1 billion from a year earlier. The government transfers surplus reached almost CZK 16.5 billion, due almost exclusively to a surplus on transfers between the Czech Republic and the EU budget. However, roughly one-half of the surplus was offset by a deficit on transfers of other sectors.

III.6.2 The capital account

The **capital account** also ended H1 in a slight surplus (CZK 0.5 billion). The year-on-year decline in the surplus by more than CZK 11 billion was due chiefly to significantly lower credits. This was mainly a result of low government sector drawdown on EU funds, which amounted to only CZK 0.9 billion. The decline in the overall surplus was also caused by the balance on trading in emission allowances, which shifted from surplus to slight deficit in year-on-year terms.

III.6.3 The financial account

The **financial account** ended 2011 H1 in a surplus of CZK 58.5 billion (see Chart III.6.5), due mainly to a net direct investment inflow and – amid a significant year-on-year change in flows – a net other investment inflow. However, roughly one-third of the surplus was offset by a net portfolio investment outflow.

Direct investment recorded a surplus of CZK 49 billion in H1 (see Chart III.6.6), representing only a slight year-on-year decrease. The overall inflow of foreign direct investment into the Czech Republic exceeded CZK 63 billion. However, it recorded a slight annual decline owing to a fall in other capital investment linked with credit relations between affiliated corporations. Its biggest component was reinvested earnings, which accounted for more than 80% of the overall inflow. Reinvested earnings were also the largest component of direct investment of domestic corporations abroad. With regard to

CHART III.6.4

INCOME BALANCE

The year-on-year change in the income balance was affected most strongly in 2011 H1 by an increase in the direct investment income deficit
(accumulation since start of year in CZK billions)

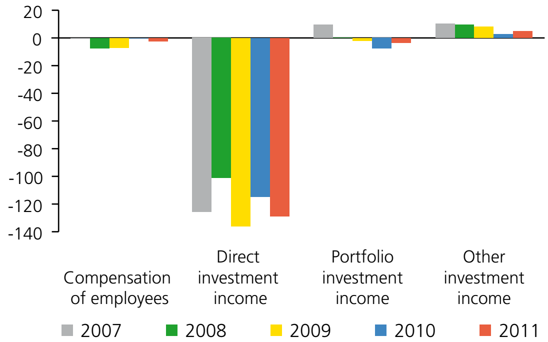


CHART III.6.5

FINANCIAL ACCOUNT

The financial account surplus increased in 2011 Q2, owing mainly to growth in the other investment surplus
(annual moving totals in CZK billions)

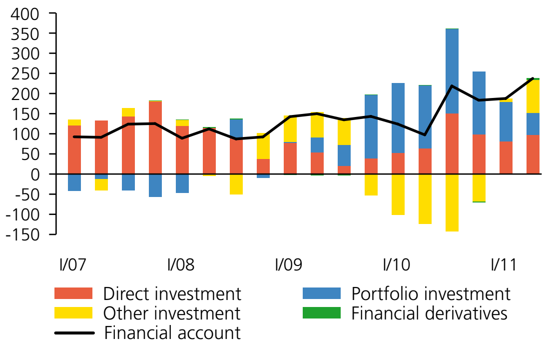


CHART III.6.6

DIRECT INVESTMENT

The direct investment surplus in 2011 H1 was mainly a result of earnings reinvested in the Czech Republic
(CZK billions)

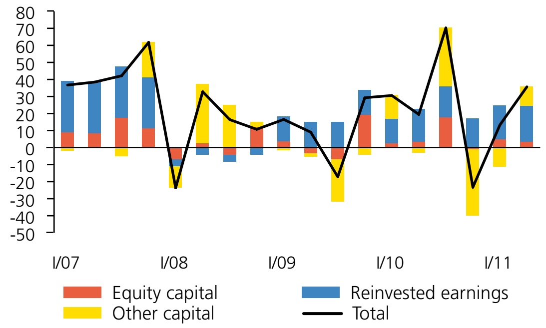


CHART III.6.7

PORTFOLIO INVESTMENT

Portfolio investment recorded in total a net outflow in 2011 H1, owing mainly to purchases of foreign securities by residents
(CZK billions)

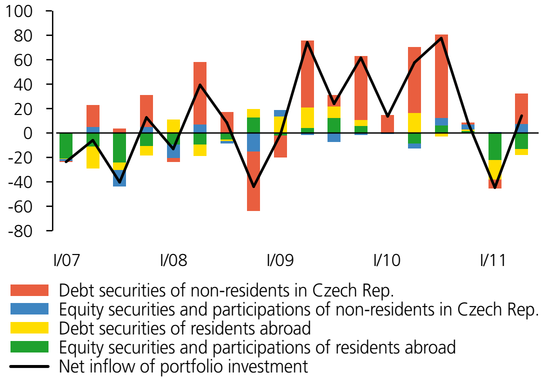
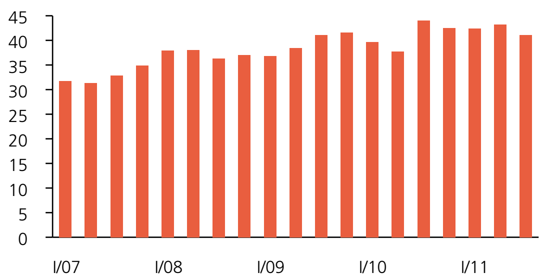


CHART III.6.8

CNB INTERNATIONAL RESERVES

The CNB's international reserves decreased in dollar terms in 2011 Q3 compared to the previous quarter
(USD billions)



industries, the foreign capital inflow (i.e. excluding reinvestment) was channelled primarily into transport and storage. The outflow of capital abroad went mainly into the electricity, gas and water supply sector.

By contrast, **portfolio investment** recorded a net outflow of CZK 30.5 billion (see Chart III.6.7). The biggest transactions were purchases of foreign securities by residents, which amounted to CZK 56 billion in H1. They were connected mainly with higher holdings of foreign shares, due probably to their higher returns compared to domestic investment opportunities. The marked rise in domestic investor demand for foreign securities was also the main reason for the year-on-year change in portfolio investment flows, which exceeded CZK 100 billion. Purchases also dominated foreign investor transactions in domestic securities. They were connected above all with issues of corporate bonds on foreign markets. Holdings also increased in the case of domestic equity securities.

Settlement of **financial derivatives** recorded a net inflow of CZK 8.1 billion. The balance rose by CZK 8 billion year on year.

Other investment also recorded a net inflow in H1 (CZK 32 billion). The overall surplus was due solely to a net inflow of almost CZK 57 billion in the monetary financial institutions sector, influenced chiefly by a drop in short-term deposits and foreign loans provided. This drop was the largest contributor to the year-on-year change in other investment flows. However, this inflow was largely offset by a net capital outflow from the corporate sector due to growth in loans provided and deposits abroad. A moderate net outflow in the government sector, related to the repayment of loans from the EIB, also fostered a decline in the overall surplus.

The CNB's **international reserves** totalled CZK 753.3 billion at the end of 2011 Q3, representing a quarter-on-quarter increase of CZK 25 billion due mainly to valuation changes. In dollar terms, the reserves declined by USD 2.1 billion to USD 41.1 billion in the same period (see Chart III.6.8). The CNB's international reserves covered more than 40% of all external debt liabilities of domestic entities at the end of Q2.

III.7 THE EXTERNAL ENVIRONMENT

Economic growth in the euro area slowed in 2011 Q2 amid accelerating consumer price inflation, while growth in producer prices moderated gradually. Leaving the main refinancing rate unchanged, the ECB extended its instruments for providing long-term liquidity to the banking sector in October and announced that it would continue to purchase government bonds of euro area periphery countries. Economic growth in the USA slowed for the third consecutive quarter. As in the euro area, the decline was accompanied by rising inflation pressures. Weak domestic consumption and fiscal restriction are the biggest risks to future economic growth on both sides of the Atlantic. The euro depreciated sharply against the dollar in September as the Greek debt crisis escalated; although it recouped some of its losses in mid-October, its outlook remains at weaker levels. The price of Brent oil has been on a slightly downward trend since April in dollar terms and was flat in koruna terms.

III.7.1 The euro area

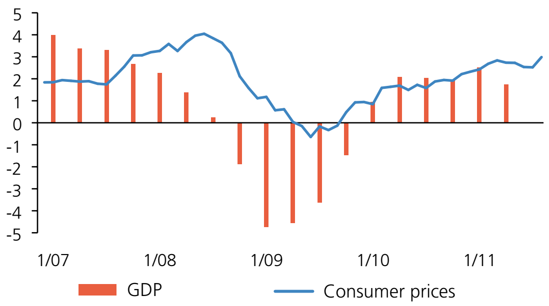
The growth rate of **economic activity** in the euro area fell by 0.7 percentage point in both annual and quarterly seasonally adjusted terms in 2011 Q2 by comparison with Q1, to 1.8% and 0.2% respectively (see Chart III.7.1). Household consumption fell in quarter-on-quarter terms for the first time since early 2009. Government expenditure recorded a modest decline, while investment, exports and imports increased. Household consumption and government expenditure recorded the largest decreases in annual growth compared to the previous quarter (0.6% and 0.4% respectively). Investment rose by 1.9% and exports and imports of goods and services by 5.5% and 4.7% respectively. However, the annual growth rates of real exports and real imports have been slowing gradually since 2010 Q3.

CHART III.7.1

GDP AND INFLATION IN THE EURO AREA

GDP growth slowed, while inflation increased to 3% in September

(annual percentage changes; source: Datastream)



Available data on industrial production (excluding construction) in the first two months of 2011 Q3 suggest an acceleration in industrial production compared to the previous quarter. However, the leading Purchasing Managers Index (PMI) for the euro area indicates worse conditions in August and September than in previous months. In September, the European Commission's index of industrial confidence also fell to its lowest level since June 2010. In Q3 so far (July and August), retail sales are also down from the previous quarter. The Commission's consumer confidence indicator dropped again in September, reaching its lowest level since August 2009. Consumer demand can therefore be expected to remain weak. Moreover, it will be dampened by restrictive fiscal measures relating to the euro area debt crisis. At 10% in August, the unemployment rate was flat for the fourth consecutive month.

In line with the above developments, the **October CF lowered its euro area GDP growth outlook** for 2011 to 1.6%. The same rate of GDP growth is expected in the autumn outlooks of other monitored organisations. If their outlooks materialise, economic growth will slow to 1.1% in 2011 H2, with private consumption rising by only 0.2%. The differences between the growth rates expected in individual euro area countries rose further compared to the previous month. On the one hand, Finland, Germany, Austria and Slovakia are each expected to record growth of around 3% for the year as a whole, while on the other hand economic contractions are predicted for Portugal and Greece.

Although economic growth slowed, **annual consumer price inflation in the euro area** rose to 2.8% in 2011 Q2 and remained roughly at this level in 2011 Q3 owing to an increase in the inflation rate to 3.0% in September. Inflation adjusted for energy and food prices also increased in September – albeit less so than headline inflation – and stood at 1.6%. Annual M3 growth accelerated to 2.8% in August.

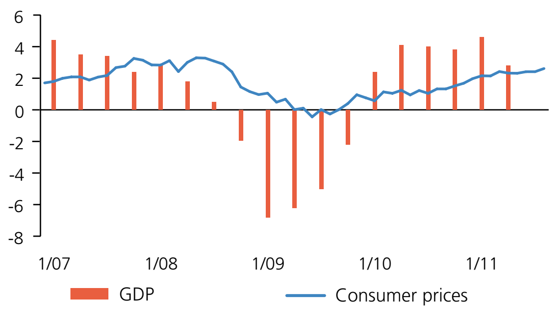
The outlooks of international institutions and CF expect elevated inflation rates above the ECB's target in 2011. Accelerating consumer price inflation probably also led the ECB to leave its key interest rate unchanged at 1.5%, although voices calling for a rate cut could be heard at the October monetary policy meeting of the Governing Council. On the other hand, the ECB announced that it would extend its instruments for providing long-term liquidity to the banking sector and would continue to purchase government bonds of euro area periphery countries to calm the financial sector during the escalating Greek debt crisis. In contrast to consumer price inflation, annual producer price inflation was flat at around 6% for the third consecutive month in August. Annual growth in industrial producer prices peaked in March and April 2011, and the effect of the previous commodity price growth is now probably unwinding. The October CF expects PPI growth of 5.8% for the year as a whole.

Chart III.7.2

GDP AND INFLATION IN GERMANY

GDP growth slowed, while inflation increased

(annual percentage changes; source: Datastream)



Economic growth in Germany slowed significantly to 2.8% year on year in 2011 Q2. This slowdown is mainly due to faltering investment and household consumption and a lower export surplus. Exports of goods and services fell again in month-on-month terms in July, but rose surprisingly in August. Imports of goods and services have been stagnant since May. Industrial production growth was lower in Q2 than in Q1 (at around 8% on average) and remained at similar levels in July and August. The unemployment rate is still at record lows. It fell to 6% in July and stayed at this level in August. CPI inflation increased in 2011 Q3 and reached 2.6% in September, the highest level in three years. The increase in the price level is due chiefly to rising prices of energy, fuels, textiles and footwear.

Retail sales were volatile, with a strong increase in July being followed by a month-on-month fall of 2.9% in August. In August, the construction output index also recorded a slight decrease and the volume of industrial orders also edged down. All **leading indicators** reflect the deteriorating confidence in the economy. In October, the ZEW economic sentiment indicator fell for the eighth consecutive month, reaching its lowest level since December 2008. By contrast, the current economic situation index remains at solid, albeit lower, levels.

The worsening outlook for the German economy is also reflected in the forecasts issued by international institutions. According to the October CF, German annual GDP growth will reach 2.9% in 2011.

BOX 3
GERMANY – THE CZECH REPUBLIC'S MAIN TRADING PARTNER

The German economy has a trade surplus vis-à-vis all its major trading partner countries except China. This merely confirms Germany's status as the "export engine" of the euro area, i.e. its key role on the European scale. The strongly export-oriented Czech economy's links with the German economy are therefore crucial.

In the last five years, Germany has accounted for more than 29% of Czech foreign trade turnover. Out of all its trading partners, the Czech Republic's trade surplus with Germany has also been the highest in the same period. This surplus has risen steadily and now exceeds the Czech Republic's overall trade surplus. The interdependence of Czech goods exports and German goods imports and exports is very high (see Chart 1). The same can also be observed for Czech goods imports as a result of strong collaboration imports.[57] The share of goods exports to Germany was 31.6% on average, with the highest share (32.5%) having been recorded in 2009, i.e. during the deepest phase of the financial crisis.

The strong link between German and Czech exports is also reflected in their structure. Machinery and transport equipment is the largest item of German exports, accounting for around 50% of the total (see Chart 2). Goods exports from the Czech Republic to Germany have a similar structure and are also dominated by machinery and equipment (see Chart 3).

Given the Czech economy's strong links with Germany and other EU countries, economic developments in these countries feed through rapidly to the Czech economy via exports. A downturn in external demand, usually accompanied by a decrease in foreign interest rates, has an immediate downward effect on domestic GDP growth. Domestic interest rates also decline in response to lower foreign rates and lower domestic cost pressures. In the initial phase, the weakening inflation pressures stemming from lower domestic GDP and business sector wages are outweighed by depreciation of the koruna resulting from worsening net exports. The slowdown

57 However, no interdependence has been proven between the Czech trade balance and the German trade balance.

CHART 1 (BOX)

EXPORTS AND IMPORTS OF GERMANY AND THE CZECH REPUBLIC

The foreign trade of the Czech Republic and Germany is highly interdependent
(EUR billions; source: CZSO, Destatis, CNB calculation)

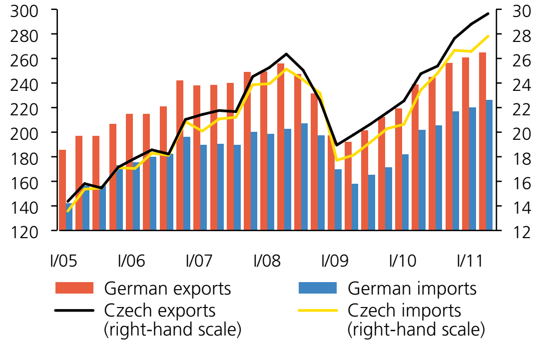


CHART 2 (BOX)

COMMODITY STRUCTURE OF GERMAN EXPORTS

Machinery and transport equipment is the largest item of German goods exports
(EUR billions; source: Destatis, CNB calculation)

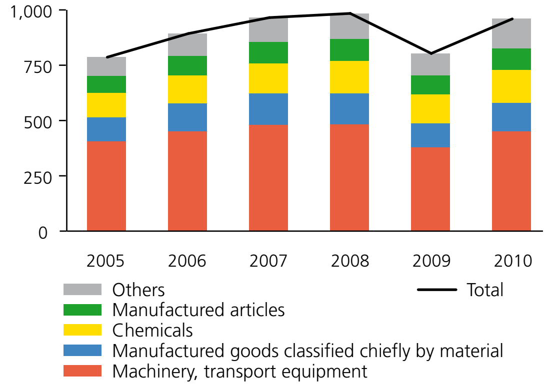
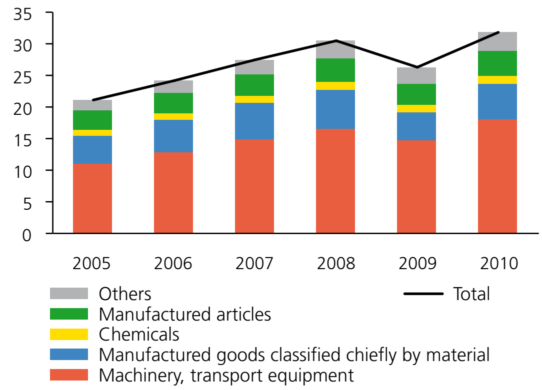


CHART 3 (BOX)

COMMODITY STRUCTURE OF CZECH EXPORTS TO GERMANY

Machinery and transport equipment accounts for more than 50% of total Czech goods exports to Germany
(EUR billions; source: Destatis, CNB calculation)



in consumer price inflation thus occurs with a lag, despite the slowdown in domestic economic activity. In the next phase, the weaker koruna fosters a rise in net exports via increasing price competitiveness of domestic producers, but it only moderates the effect of the contraction in external demand.[58]

In contrast to Germany and the euro area as a whole, the **growth of Slovak GDP** in 2011 Q2 maintained the pace observed in Q1. GDP increased by 3.5% year on year and 0.9% quarter on quarter (see Chart III.7.3). As regards the breakdown of annual GDP growth, government expenditure declined, household consumption was flat and gross capital formation increased. The goods and services surplus also rose by more than one-half on a year earlier. However, the growth rate of industrial production has been slowing gradually since the start of the year. In 2011 Q2 it reached 7.9%, and in July and August it moderated further to 4.2%. The unemployment rate responded with modest growth starting in June and stood at 13.4% in September. The October CF estimates that Slovak GDP will reach 3.2% in 2011 as a whole amid very low household consumption growth (0.5%).

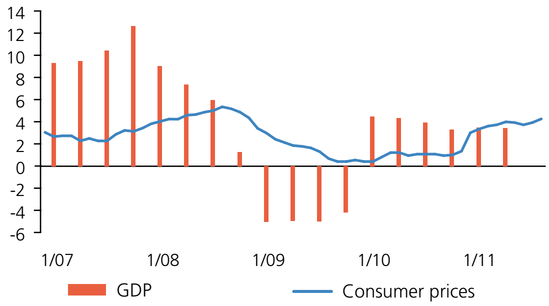
As in the euro area as a whole, annual **consumer price inflation** in Slovakia rose in September, reaching 4.3%. According to the October CF, inflation should be 4.1% on average in the rest of the year. Annual producer price inflation started coming down in March and was only 2.0% in August.

CHART III.7.3

GDP AND INFLATION IN SLOVAKIA

GDP growth was flat in 2011 Q2, while inflation increased in September

(annual percentage changes; source: Datastream)



III.7.2 The United States

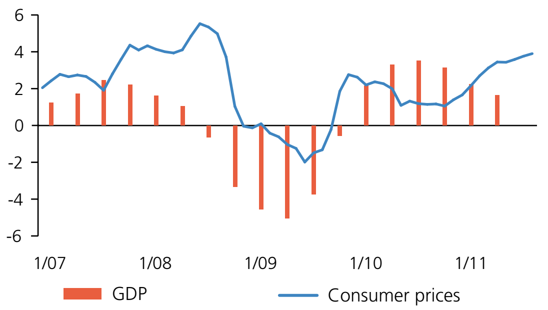
Annual GDP growth in the USA slowed further to 1.6% in 2011 Q2 (see Chart III.7.4). In quarter-on-quarter terms, the economic growth amounted to 0.3%. The decline in economic growth was due not only to external factors (the earthquake in Japan, high oil prices, the debt crisis in Europe and the economic slowdown in emerging economies), but also to internal factors (weak consumer demand and falling government expenditure). In particular, high unemployment and expected cuts in social and other fiscal expenditure (of around 2% of GDP as from January 2013) reduced consumer confidence and consumer demand. The Fed's ability to boost economic growth by further easing monetary policy is also limited. The economic situation is further complicated by the radicalisation of both main political parties ahead of the presidential election in autumn 2012. This almost rules out the optimal setting of fiscal stimuli and austerity measures to ensure a reduction of the very high public debt-to-GDP ratio in the medium term without jeopardising the current fragile recovery.

CHART III.7.4

GDP AND INFLATION IN THE USA

GDP growth slowed further in 2011 Q2, while inflation pressures were relatively high

(annual percentage changes; source: Datastream)



58 Alternative scenarios regarding the external environment and their impacts on the Czech economy are quantified in Inflation Report I/2011 and in this Inflation Report IV/2011 (see section II.4).

Economic growth can be expected to edge down again in **2011 H2** compared to H1. In 2011 Q3, industrial production continued to rise at around 3.3% year on year and capacity utilisation increased modestly. Unemployment remained at 9.1% and annual employment growth edged up to 1%. The October CF expects GDP to grow by around 1.5% in 2011 H2 and lowered its prediction by 1 percentage point compared to July. Leading indicators are also suggesting continuing modest GDP growth.

The **annual inflation rate** increased somewhat to 3.8% in 2011 Q3. However, the October CF expects it to fall to 3.1% in the rest of 2011. The higher inflation was due mainly to increases in prices of energy (of 19%), food (of 5.0%) and other commodities. At its meeting on 20 and 21 September, the FOMC left its key rate unchanged at 0–0.25% and indicated that it would most likely maintain it at this level at least until mid-2013. The FOMC also intends to change the structure of its assets over the next ten months (by June 2012) by purchasing long-term securities (6–30 years) and selling short-term ones (up to 3 years). The value of the bonds purchased and sold should be USD 400 billion. The aim of this measure is to reduce long-term interest rates and thereby support investment and the mortgage market. The FOMC decided to reinvest yields on mortgage bonds back in these instruments in order to strengthen the mortgage market. It also indicated that has other instruments to support economic activity and is ready to use them if necessary.

III.7.3 The exchange rate of the euro against the dollar and other major currencies

In 2011 Q3, the euro depreciated against global currencies such as the Japanese yen and the pound sterling (see Chart III.7.5). Uncertainty regarding the solution to the euro area debt crisis dampened demand for the euro. By contrast, currencies perceived as safe havens appreciated. In August, the Swiss franc strengthened considerably against the euro (by 20% compared to January 2011). This led the Swiss central bank to set a minimum exchange rate of CHF 1.2 per euro as from 6 September. The euro started to weaken against the US dollar in September. In July and August the exchange rate was between USD 1.40 and 1.45 to the euro. The dollar was supported by the decision of the US central bank to finance further purchases of long-term bonds by sales of short-term ones. The euro strengthened considerably only against some European currencies such as the Polish zloty and the Hungarian forint (by 12% and 10% respectively at the end of September compared to July).

The depreciation trend against global currencies was reversed in **mid-October 2011** and the euro strengthened slightly. However, further appreciation of the European currency is being prevented by an expected slowdown in euro area economic growth, which was already visible in Q2, and by the adverse effect of the continuing debt crisis. An expected decrease in the outlook for euro area market interest rates is also acting against the euro.

CHART III.7.5

EURO EXCHANGE RATE AGAINST MAJOR CURRENCIES

The euro weakened against major currencies in 2011 Q3

(January 2007 = 100; source: Datastream, outlook from CF)

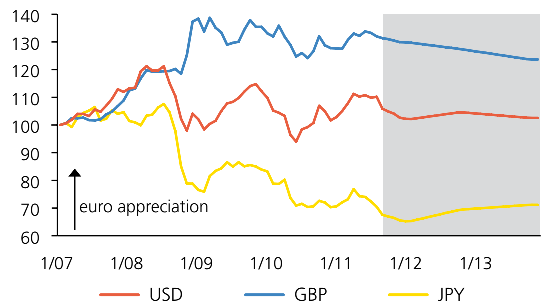


Chart III.7.6

OIL AND NATURAL GAS PRICES IN USD

The price of Brent crude oil is expected to fall gradually to less than USD 100 a barrel in 2013

(oil in USD/barrel; gas in USD/1000 m³ – right-hand scale; source: IMF, Bloomberg)

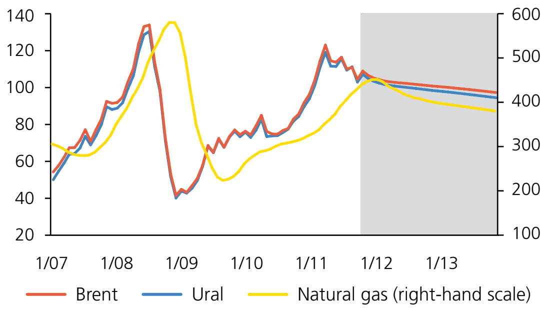
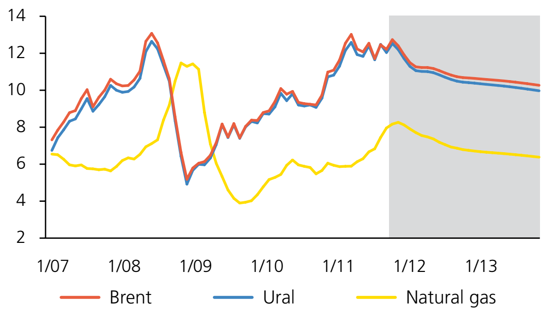


Chart III.7.7

OIL AND NATURAL GAS PRICES IN CZK

The koruna price of Brent crude oil has been broadly flat since March, but is expected to fall over the forecast horizon

(oil in CZK/litre; gas in CZK/m³; source: IMF, Bloomberg, CNB calculation)



The **October CF** expects the euro to stand at USD 1.33/EUR at the two-year horizon. In the longer term, the euro should appreciate slightly vis-à-vis the Japanese yen and depreciate gradually vis-à-vis the pound sterling.

III.7.4 Prices of oil and other commodities

The dollar **price of Brent oil** has been fluctuating around a slightly downward trend roughly since April 2011 (see Chart III.7.6). Periods of gradual growth have been alternating with sharp falls. In the first half of September the price of Brent oil fluctuated between USD 110 and 115 a barrel, with financial market turbulence being counteracted by fundamentals in the form of relatively robust demand from China and falling extraction in the North Sea. In the rest of the month, the price recorded another relatively sharp fall triggered by adverse data on US consumer confidence and unsuccessful meetings of euro area finance ministers regarding aid to Greece.

The IMF lowered its global growth forecast and did not rule out a return of the US and European economies to recession. The Fed issued a similar assessment, and investors were also unnerved by data on falling industrial production in China and a shrinking services sector in the euro area. When reports emerged in early October regarding the problems of the Belgian-French financial group Dexia and euro area finance ministers decided to postpone the next instalment of the loan to Greece, Brent oil fell below USD 100 a barrel for the first time since February. As with the previous three declines, however, a fast upward correction followed, with the price of Brent oil moving above USD 110 a barrel again in mid-October. Investors were calmed by plans to recapitalise European banks, by more favourable economic data and by a decrease in US oil inventories. In koruna terms, the average monthly price of Brent oil has remained almost unchanged since March (see Chart III.7.7).

Both the IEA and OPEC again reduced their **estimates of future demand for oil**. The IEA is more optimistic in its forecast, however, as it is not expecting any marked drop in demand in Asia and the Middle East. Demand should also be strong in Japan, as oil and natural gas should cover the shutdown of Japan's nuclear power stations. On the supply side, extraction problems occurred in Nigeria, whereas a gradual renewal of extraction was reported in Libya. OPEC expects extraction to rise in Canada, the USA, Brazil and Colombia in 2012.

The **market outlook** for the Brent oil price based on futures fell by around USD 14 a barrel compared to the previous forecast. In mid-2013 the forecast falls below USD 100 a barrel.[59] The futures curve

59 For comparison, Morgan Stanley analysts lowered their forecast for 2012 from USD 130 to USD 100 a barrel. By contrast, Goldman Sachs continues to expect high prices and revised its forecast by only USD 10 to USD 120 a barrel.

remains downward-sloping. The market thus does not foresee any problems with future supply and expects it to rise thanks to the gradual resumption of Libyan oil supplies. A slightly downward-sloping curve is the norm on the oil market from the historical perspective. At the same time, surface oil reserves are gradually falling.[60] Oil processors are thus postponing purchases and consuming stocks.[61]

Following a strong and virtually across-the-board decline in price of industrial and food commodities during September, the average monthly **non-energy commodity price index** was 20% below its February peak in the first half of October (see Chart III.7.8). The food commodity sub-index recorded a smaller decrease (of 12%), while the industrial commodities component fell more markedly (by 28%, of which industrial metals by 24%). The forecast based on futures contracts expects only modest growth from the current levels.

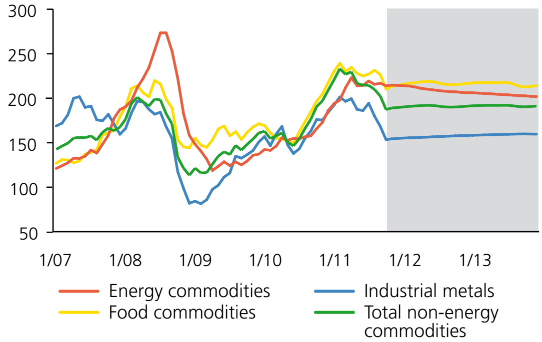
The **energy commodity price index** has been broadly flat since March, with the falling price of oil being offset by a lagged increase in natural gas prices. However, gas prices should also start to fall in early 2012, so coal prices remain the only item in the index with a rising outlook.

CHART III.7.8

COMMODITY PRICES

Energy commodity prices were broadly flat in 2011 Q3, while the average non-energy commodity price index fell quite significantly

(2005 = 100; source: Bloomberg)



Note: The structure of the non-energy commodity indices corresponds to the composition of the Economist's commodity indices; the energy commodity index consists of Brent crude oil (0.4), coal (0.4) and natural gas (0.2).

60 Reserves in the OECD dropped below the five-year average in February (owing mainly to European countries) and have fallen further since then. According to preliminary IEA data, this trend continued into September. Stocks in short-term storage containers have been falling in particular.

61 In part, this may be a case of speculative activity by dealers who own storage capacity. However, major investors are reducing their long positions, which peaked in April in connection with the loss of Libyan oil supplies. Their positions are still higher than they were a year earlier, but the decline in activity may push the futures curve downwards.

CF	Consensus Forecasts
CHF	Swiss franc
CNB	Czech National Bank
COSMC	Czech Office for Surveying, Mapping and Cadastre
CPI	consumer price index
CZK	Czech koruna
CZSO	Czech Statistical Office
ECB	European Central Bank
EIB	European Investment Bank
ERM II	Exchange Rate Mechanism
ESA 95	European System of National Accounts
ESCB	European System of Central Banks
EU	European Union
EUR	euro
Euribor	Euro Interbank Offered Rate
Fed	US central bank
FOMC	Federal Open Market Committee
FMIE	Financial Market Inflation Expectations
FRA	forward rate agreement
GBP	pound sterling
GDP	gross domestic product
GVA	gross value added
HICP	Harmonised Index of Consumer Prices
HP filter	Hodrick-Prescott filter
IEA	International Energy Agency
ILO	International Labour Organization
IMF	International Monetary Fund
IPP	industrial producer price index
JPY	Japanese yen
LFS	Labour Force Survey
LIBOR	London Interbank Offered Rate
M1, M2, M3	monetary aggregates
MLSA	Ministry of Labour and Social Affairs
NiGEM	National Institute's Global Econometric Model
OECD	Organisation for Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
PAYG	pay-as-you-go
PMI	Purchasing Managers Index
PPI	producer price index
PRIBOR	Prague Interbank Offered Rate
(1W, 1M, 1Y)	(one-week, one-month, one-year)
repo rate	repurchase agreement rate
USD	US dollar
VAT	value added tax
ZEW	Centre for European Economic Research

Price indices used for the evaluation of inflation	(Box)	April 1998
Analysis of the money supply trend	(Box)	July 1999
Revisions to the statistical data on GDP	(Box)	July 1999
Measuring the inflation expectations of the financial market	(Annex)	October 1999
Oil prices and their impact on inflation	(Box)	July 2000
The effect of oil price changes on the balance of trade	(Box)	October 2000
The methodological framework for evaluating wage developments relative to inflation	(Box)	January 2001
The CNB's monetary policy rates	(Box)	April 2001
The setting of the inflation target for 2002–2005	(Annex)	April 2001
Harmonisation of the reserve requirements with European Central Bank standards	(Annex)	April 2001
Escape clauses pertaining to the new inflation target	(Annex)	July 2001
Changes in economic growth forecasts in the eurozone, Germany, the USA and Japan for 2001 and 2002	(Annex)	October 2001
Strategy for dealing with the exchange rate effects of capital inflows from privatisation of state property and from other foreign exchange revenues of the state	(Annex)	January 2002
Assessment of fulfilment of the CNB's net inflation target in December 2001	(Annex)	January 2002
Prediction of external variables	(Box)	April 2002
Estimated capital flows in 2002 and 2003 and their effect on the exchange rate	(Box)	April 2002
The Balassa–Samuelson effect	(Annex)	April 2002
The CNB changes its type of inflation forecast	(Box)	July 2002
An assessment of the effect of the August floods on Czech economic growth	(Box)	October 2002
The financial conditions of the Czech Republic's accession to the EU	(Box)	January 2003
Implications of the unexpectedly slow growth in regulated prices	(Box)	January 2003
The Czech Republic and the euro – Draft accession strategy	(Annex)	January 2003
Fiscal consolidation and its effect on economic growth	(Annex)	January 2003
Price deregulation in the period of transformation of the Czech economy of the Czech economy	(Box)	April 2003
Revisions to the March 2003 GDP figures	(Box)	April 2003
Credit to households	(Box)	July 2003
The withdrawal of 10- and 20-heller coins and its possible impact on prices	(Box)	July 2003
Indirect taxes and the inflation forecast	(Box)	July 2003
Changes to the methodology for surveying inflation expectations	(Box)	July 2003
ERM II and the exchange-rate convergence criterion	(Annex)	July 2003
Use of the output gap indicator at the CNB	(Box)	October 2003
Monetary policy in the CNB's macroeconomic forecast	(Box)	October 2003
The Czech Republic's euro-area accession strategy	(Annex)	October 2003
Short-run food price prediction methods	(Box)	January 2004
Monetary conditions	(Box)	April 2004
The CNB's inflation target from January 2006	(Annex)	April 2004
The CNB has fully integrated into the European System of Central Banks	(Annex)	July 2004
The exchange rate in the CNB's forecasting system	(Box)	July 2004
Indicators of households' financial situation	(Box)	October 2004
GDP data revision	(Box)	October 2004
Petrol prices and their impact on inflation in the Czech Republic	(Box)	October 2004
Assessment of the fulfilment of the Maastricht convergence criteria and the degree of alignment of the Czech economy with the euro area	(Annex)	January 2005
The structure of lending	(Box)	January 2005
Uncertainty regarding the evolution of public finances in 2005 and 2006	(Box)	January 2005
Inflation expectations in the CNB's modelling system	(Box)	January 2005
The transmission of external cost shocks into domestic prices in 2003–2005	(Box)	April 2005
The effect of the exchange rate on inflation	(Box)	April 2005
The Czech National Bank's position on the revision of the Stability and Growth Pact	(Annex)	April 2005
The effect of EU accession on prices and inflation expectations	(Box)	July 2005
Foreign trade in the first year after the Czech Republic's accession to the EU	(Box)	July 2005
Financial flows between the Czech Republic and the European Union	(Box)	July 2005
The effect of world energy prices on consumer prices	(Box)	October 2005
The performance of large non-financial corporations 1998–2004	(Box)	October 2005

Potential output in the CNB's forecasting system	(Box)	October 2005
Fiscal policy in the CNB's modelling system	(Box)	January 2006
Assessment of the fulfilment of the Maastricht Convergence criteria		
and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	January 2006
Implications of household debt for consumption	(Box)	April 2006
Effective indicators of external developments	(Box)	July 2006
Oil and petrol prices in the CNB forecast	(Box)	July 2006
The role of monetary aggregates in the CNB's forecasts	(Box)	October 2006
Assessment of the fulfilment of the Maastricht convergence criteria		
and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	October 2006
Employment of foreign nationals	(Box)	January 2007
The extension of the core prediction model to include the effect of real wages	(Box)	January 2007
The new consumer basket as from January 2007	(Box)	April 2007
Financing of non-financial corporations	(Box)	April 2007
The application of escape clauses to indirect tax changes	(Box)	April 2007
The CNB's new inflation target and changes in monetary policy communication	(Annex)	April 2007
The relationship between interest rates and the structure of new loans for house purchase	(Box)	July 2007
The CNB's new approach to the monitoring of inflation expectations of households in the Czech Republic	(Box)	July 2007
The causes, course and impacts of the current turmoil in global financial markets	(Box)	October 2007
Household debt by income group in 2006 and its impact on consumption	(Box)	October 2007
The causes of the sharp growth in world prices of cereals	(Box)	October 2007
Fiscal measures and their impact on the economy in 2008	(Box)	October 2007
The Czech Republic's updated euro-area accession strategy	(Annex)	October 2007
Changes in the conduct and communication of monetary policy	(Box)	I/2008
Publication of the forecast-consistent interest rate path and the use of fan charts	(Box)	I/2008
The quarterly financial accounts statistics – New statistics at the CNB	(Box)	I/2008
Changes to the CNB's core prediction model	(Box)	I/2008
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and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	I/2008
The new g3 structural model	(Box)	II/2008
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for dealing with the exchange rate effects of foreign exchange revenues of the state	(Annex)	II/2008
The sectoral and production structure of the g3 model	(Box)	III/2008
The withdrawal of 50-heller coins and its possible impact on prices	(Box)	III/2008
The impact of the still fast growing world prices of energy-producing materials on inflation in the Czech Republic	(Box)	IV/2008
Pricing in the g3 model	(Box)	IV/2008
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Assessment of the fulfilment of the Maastricht convergence criteria and the degree of economic alignment		
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Analysts' forecasts in financial market inflation expectations questionnaires: A look back at the past ten years	(Box)	II/2009
Unconventional monetary policy of selected central banks	(Box)	III/2009
Financing and financial investment of corporations and households	(Box)	III/2009
The impact of the recession on public finances in the Czech Republic	(Box)	III/2009
Investment in housing during the business cycle	(Box)	IV/2009
The effect of regulated prices and other administrative measures on inflation in 2008–2009 and their expected future development	(Box)	IV/2009
Exit strategies from unconventional monetary policy instruments planned by selected central banks	(Box)	I/2010
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Differences in client interest rates in the Czech Republic and the euro area	(Box)	I/2010
Assessment of the fulfilment of the Maastricht convergence criteria		
and the degree of economic alignment of the Czech Republic with the euro area	(Annex)	I/2010

Assessment of the accuracy of the outlooks for effective GDP and CPI in the euro area – comparison of forecasts	(Box)	II/2010
Revisions to the expenditure components of GDP	(Box)	II/2010
Business and consumer sentiment in the current phase of the economic cycle according to CZSO and CNB indicators	(Box)	II/2010
The January 2010 consumer basket update	(Box)	II/2010
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Price-setting behaviour in the Czech Republic (micro data evidence) in relation to the pricing mechanism		
in the g3 forecasting model	(Box)	II/2011
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The debt situation in Italy	(Box)	III/2011
Publication of the Graph of Risks to the Inflation Projection (GRIP)	(Annex)	III/2011
Pension system reform	(Box)	IV/2011
The credit rating of the Czech Republic	(Box)	IV/2011
Germany – the Czech Republic's main trading partner	(Box)	IV/2011

This glossary explains some terms frequently used in the Inflation Report. A more detailed glossary can be found on the CNB website (www.cnb.cz/en/general/glossary/index.html).

Adjusted inflation excluding fuels: The increase in prices of non-food items of the consumer basket excluding items with administered prices, indirect tax changes and fuels.

Administered prices: A sub-category of the consumer basket consisting of items with price ceilings (set at either central or local level), prices regulated on a cost-plus basis (items whose prices may only reflect economically justified costs and a reasonable profit) and administratively fixed fees. The selection of these items is based on the Price Bulletin of the Czech Ministry of Finance.

Balance of payments: Records economic transactions with other countries (i.e. between residents and non-residents) over a particular period. The basic structure of the balance of payments includes the current account, the capital and financial accounts and the change in CNB international reserves.

Consensus Forecasts: A regular monthly publication issued by Consensus Economics bringing together the forecasts of hundreds of prominent economists and analytical teams regarding future world developments. The CNB uses these predictions in its macroeconomic forecast when forming assumptions regarding the future development of the external environment.

Covered bond: A bond collateralised (backed) by long-term assets, usually mortgage loans or public sector loans. The issuers are mostly banks and the issuance of covered bonds is subject to strict legislative rules. Compared to standard bonds, this type of bond has lower credit risk thanks to higher coverage (known as dual recourse), which gives the covered bond holder a preferential claim on the issuer's receivables underlying the mortgage loans or public sector loans and likewise a claim on the issuer. If the issuer defaults, the holder therefore has a preferential right to the assets backing the covered bond.

Current account: Records exports and imports of goods and services, income from capital, investment and labour and unrequited transfers.

Cyclical component of the general government balance: Expresses the effect of the business cycle on the general government fiscal balance.

Discount rate: A monetary policy rate which as a rule represents the floor for short-term money market interest rates. The CNB applies it to the excess liquidity which banks deposit with the CNB overnight under the deposit facility.

Disinflation: A decline in inflation.

Effective euro area indicators: Proxy for the effect of economic activity (effective GDP) and inflation (effective producer prices and consumer prices) in the euro area on the Czech economy. The weights used in the calculation are the shares of the individual euro area economies in the foreign trade turnover of the Czech Republic.

Effective exchange rate: Shows the appreciation (index > 100) or depreciation (index < 100) of the national currency against a basket of selected currencies for a certain time period relative to a base period. The weights applied in the basket are the shares of major trading partners in foreign trade turnover.

Escape clause: Excuses the central bank from its obligation to hit the inflation target. In the flexible inflation targeting regime, it is applied in the event of large shock changes in exogenous factors (particularly supply-side shocks, e.g. indirect tax changes) that are completely or largely outside the purview of central bank monetary policy.

Euro area: The territory of all Member States of the European Union that have adopted the euro as a single currency pursuant to the Treaty Establishing the European Community.

Financial account: Records transactions connected with the creation, liquidation and change in ownership of the financial assets and liabilities of the government, the banking and corporate sectors and other entities vis-à-vis the rest of the world. It consist of direct investment, portfolio investment, other investment and financial derivatives transactions.

Fiscal position: The annual change in the general government structural balance (in percentage points). A positive figure indicates fiscal restriction and a negative figure indicates fiscal expansion.

Food prices: In CNB documents, the term food prices refers to the consolidated category of prices of food and non-alcoholic beverages and prices of alcoholic beverages and tobacco.

General government balance: Revenues minus expenditures of the general government sector. A negative government balance is called a general government deficit and a positive government balance is called a general government surplus.

General government primary balance: The general government balance net of interest payments (i.e. debt service).

General government structural balance: The cyclically adjusted general government balance adjusted for extraordinary one-off operations. It captures the structural configuration of fiscal policy.

Goods and services balance: The sum of the trade balance and the services balance.

Gross Domestic Product (GDP): The key indicator of economic development. It represents the sum of the value added by all economic sectors. In terms of use it consists of expenditure on final consumption (consumption of households, the government and non-profit institutions), gross capital formation (fixed investment and changes in inventories) and foreign trade (net exports of goods and services).

Inflation: Commonly, inflation is considered to be recurring growth of most prices in the economy. It means a decrease in the real value (i.e. purchasing power) of a given currency relative to the goods and services which consumers buy – if there is inflation in the economy, consumers need ever more currency units of the given country to buy the same basket of goods and services. In practice, inflation is measured by the increment of the consumer price index.

Inflation pressures: Proxied in the CNB's modelling system by the real marginal cost gap in the consumer goods sector. Total inflation pressures are divided into domestic inflation pressures (in the intermediate goods sector) and imported inflation pressures (in the import price sector).

Inflation rate: The increase in the average (basic) consumer price index for the last 12 months relative to the average for the previous 12 months.

Inflation target: The level of consumer price inflation that the CNB endeavours to achieve, set publicly and well in advance.

Lombard rate: A monetary policy interest rate which provides a ceiling for short-term interest rates on the money market. The CNB applies it to the liquidity which it provides to banks overnight under the lending facility.

Monetary aggregates: Represent the amount of money in the economy covered in the monetary survey. According to the national definition, they are calculated from the monetary liabilities of resident monetary financial institutions to other resident sectors in the Czech Republic (households, non-financial corporations and financial institutions excluding the general government). Monetary aggregates differ according to the degree of liquidity of the individual components. The narrow monetary aggregate M1 comprises currency in circulation and overnight deposits. The broad monetary aggregate M2 comprises M1 plus total deposits with agreed maturity and redeemable at notice and repurchase agreements. The broad monetary aggregate M3 (harmonised with EU standards) comprises currency in circulation, overnight deposits, deposits with agreed maturity of up to two years, deposits redeemable at notice of up to three months, repurchase agreements, money market fund shares/units and issued debt securities with maturity of up to two years.

Monetary conditions: Represent the combined effect of interest rates (the interest rate component of the monetary conditions) and the exchange rate (the exchange rate component) on the economy. These are the key variables through which monetary policy can affect economic activity and, through it, inflation. Interest rates and the exchange rate do not necessarily affect the economy in the same direction.

Monetary policy horizon: The time horizon which monetary policy-makers focus on when making decisions and which takes into account the monetary policy transmission lag. This horizon is about 12–18 months ahead.

Monetary policy interest rates: Short-term interest rates associated with monetary policy-making. They comprise the two-week repo rate, the discount rate and the Lombard rate.

Monetary-policy relevant inflation: Inflation to which monetary policy reacts. It is defined as headline inflation adjusted for the first-round effects of changes to indirect taxes.

Money market: The part of the financial markets which is used to obtain short-term loans and where debt instruments maturing in less than one year are traded. T-bills are typical securities traded on this market. Within this market the CNB carries out its repo operations.

Net inflation: Consumer price inflation net of administered prices and adjusted for the first-round effects of changes to indirect taxes. Net inflation consists of food price inflation, fuel price inflation and adjusted inflation excluding fuels. Until the end of 2001, the CNB's inflation targets were set in terms of net inflation. Since 2002, the CNB has targeted headline inflation, using net inflation for analytical purposes only.

Nominal costs in the consumption sector: These comprise output prices in the intermediate goods sector and import sector, as final consumption goods are produced using inputs from these sectors. They also include "export-specific technology", which approximates the productivity differential between the tradables sector and the non-tradables sector and its price effect, known as an analogy to the Balassa-Samuelson effect.

Nominal costs in the intermediate goods sector: Co-determined by prices of production factors, i.e. labour costs and the price of capital. In addition to these components, they are determined by "labour-augmenting technology". This technology can be understood as a concept similar to total factor productivity, e.g. in the Cobb-Douglas production function.

Nominal unit labour costs: The labour costs needed to produce a unit of output. Nominal unit labour costs are calculated as the ratio of the nominal volume of wages and salaries to GDP at constant prices.

Price-to-income ratio: The ratio of the price of an apartment (68 m^2) to the sum of the annual wage in a given region over the last four quarters. Higher values of this indicator usually mean that apartments are overpriced.

Price-to-rent ratio: Indicator of sustainability of apartment prices, calculated as the ratio of the price of the apartment to the annual rent. The price-to-rent ratio is the inverse of the rent return. Higher values of this indicator usually mean that apartments are overpriced.

Producers' margins: The inverse of producers' real marginal costs in the relevant sector. Growth in producers' nominal costs without corresponding growth in the price of production causes a decline in the profit margin, i.e. an increase in real marginal costs. If prices in the sector were perfectly flexible, the price at any given moment would comprise a constant margin over marginal nominal costs. In the consumer sector, a gap in profit mark-ups represents a deviation from the long-term margin level.

Property transaction prices: Prices based on Ministry of Finance statistics from property transfer tax returns and published by the CZSO. These prices are the closest to actual market prices in terms of methodology, but are published with a time delay. Formerly also referred to as property transfer prices in CNB publications.

Property asking prices: Property sale asking prices in estate agencies. Asking prices should be higher than transaction prices. Property asking prices in the Czech Republic are published, for example, by the CZSO and the Institute for Regional Information (IRI). Formerly also referred to as property supply prices in CNB publications.

Repo rate: The CNB's key monetary policy rate, paid on commercial banks' excess liquidity as withdrawn by the CNB in two-week repo tenders.

Unemployment rate: The ratio of the number of unemployed persons to the total labour force. We distinguish between the general unemployment rate, as determined by the CZSO according to International Labour Organisation methodology, and the registered unemployment rate, as determined by the Ministry of Labour and Social Affairs.

KEY MACROECONOMIC INDICATORS

		years										
		2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
DEMAND AND SUPPLY												
Gross domestic product												
GDP	CZK bn, constant p., seas. adjusted	2,368.4	2,470.8	2,628.5	2,812.2	2,984.7	3,053.3	2,930.6	2,994.8	**3,054.4**	**3,091.7**	**3,174.0**
GDP	%, y-o-y, real terms, seas. adjusted	3.6	4.3	6.4	7.0	6.1	2.3	-4.0	2.2	**2.0**	**1.2**	**2.7**
Household consumption	%, y-o-y, real terms, seas. adjusted	5.9	2.8	2.6	5.2	4.9	3.4	-0.2	-0.1	**-0.4**	**1.6**	**2.1**
Government consumption	%, y-o-y, real terms, seas. adjusted	7.1	-3.5	2.9	1.2	0.5	1.1	2.6	-0.1	**-1.8**	**0.5**	**-0.3**
Gross capital formation	%, y-o-y, real terms, seas. adjusted	-1.4	8.4	-0.6	10.2	9.4	-3.2	-15.5	5.3	**1.9**	**4.7**	**3.9**
Exports of goods and services	%, y-o-y, real terms, seas. adjusted	7.2	20.3	11.8	16.2	15.0	5.7	-10.5	17.7	**9.4**	**2.9**	**8.2**
Imports of goods and services	%, y-o-y, real terms, seas. adjusted	8.0	17.5	5.2	14.7	14.2	4.3	-10.4	17.6	**7.2**	**4.1**	**7.6**
Net exports	CZK bn, constant p., seas. adjusted	-170.7	-152.5	-26.1	3.6	24.5	65.8	55.1	65.2	**144.0**	**106.1**	**134.0**
Coincidence indicators												
Industrial production	%, y-o-y, real terms	1.6	10.4	3.9	8.3	10.6	-1.8	-13.6	10.3	-	-	-
Construction output	%, y-o-y, real terms	9.3	8.8	5.2	6.0	7.1	0.0	-0.9	-7.1	-	-	-
Receipts in retail sales	%, y-o-y, real terms	7.2	3.8	8.1	10.8	10.0	2.7	-4.7	1.3	-	-	-
PRICES												
Main price indicators												
Inflation rate	%, end-of-period	0.1	2.8	1.9	2.5	2.8	6.3	1.0	1.5	-	-	-
Consumer Price Index	%, y-o-y, average	0.1	2.8	1.9	2.5	2.8	6.4	1.1	1.5	**1.8**	**2.7**	**1.6**
Administered prices (17.15%)*	%, y-o-y, average	0.6	3.5	5.7	9.3	4.8	15.6	8.4	2.7	**4.6**	**6.3**	**2.7**
Net inflation (82.85%)*	%, y-o-y, average	0.0	1.8	0.7	0.4	1.7	2.4	-0.9	0.0	**1.1**	**0.8**	**1.6**
Food prices (including alcoholic beverages and tobacco) (25.63%)*	%, y-o-y, average	-1.2	2.8	0.0	-0.2	3.8	3.0	-0.9	0.9	**3.5**	**1.4**	**1.5**
Adjusted inflation excluding fuels (53.52%)*	%, y-o-y, average	0.6	1.2	0.7	0.6	0.7	2.0	0.0	-1.2	**-0.7**	**0.4**	**1.8**
Fuel prices (3.70%)*	%, y-o-y, average	1.5	4.5	7.8	3.7	-0.3	4.3	-11.1	11.8	**9.8**	**2.2**	**-0.3**
Monetary-policy inflation (excluding tax changes)	%, y-o-y, average	0.1	2.0	1.8	2.3	2.2	4.4	0.9	0.4	**1.7**	**1.5**	**1.7**
GDP deflator	%, y-o-y, seas. adjusted	0.9	4.5	-0.3	1.1	3.4	1.8	2.5	-1.2	**0.5**	**0.8**	**2.5**
Partial price indicators												
Producer prices	%, y-o-y, average	-0.3	5.6	3.1	1.4	4.1	4.5	-3.1	1.2	**5.5**	**2.2**	**1.9**
Agricultural prices	%, y-o-y, average	-4.5	9.6	-9.8	1.3	16.4	10.8	-24.3	5.6	**19.9**	**-6.5**	**0.1**
Construction work prices	%, y-o-y, average	2.2	3.7	3.0	2.9	3.9	4.5	1.2	-0.2	-	-	-
Brent crude oil	%, y-o-y, average	15.5	32.7	42.3	20.0	11.1	34.5	-36.7	28.7	**38.5**	**-7.0**	**-3.5**
LABOUR MARKET												
Average monthly wage	%, y-o-y, nominal terms	5.8	6.3	5.0	6.6	7.2	7.8	3.3	1.9	**2.4**	**3.8**	**4.2**
Average monthly wage	%, y-o-y, real terms	5.7	3.4	3.0	4.0	4.3	1.4	2.3	0.4	**0.6**	**1.1**	**2.6**
Number of employees	%, y-o-y	-2.0	-0.2	2.2	1.2	1.9	1.7	-2.1	-2.1	**0.4**	**0.1**	**0.0**
Nominal unit wage costs	%, y-o-y	2.3	1.8	0.6	1.0	3.0	6.1	4.3	-1.1	**0.6**	**2.6**	**1.5**
Nominal unit wage costs in industry	%, y-o-y	3.4	-4.5	-4.0	-5.6	0.9	0.3	4.4	-6.5	-	-	-
Aggregate labour productivity	%, y-o-y	3.6	4.1	5.2	4.8	3.4	1.2	-3.0	3.2	**1.6**	**1.1**	**2.5**
ILO general unemployment rate	%, average, age 15–64	7.8	8.4	8.0	7.2	5.4	4.4	6.7	7.4	**7.1**	**7.1**	**6.9**
Registered unemployment rate	%, average	-	10.0	9.5	8.6	7.0	5.8	8.3	9.3	**8.9**	**8.8**	**8.2**
PUBLIC FINANCE												
Public finance deficit (ESA95)	CZK bn, current p.	-179.8	-82.9	-101.1	-79.2	-26.7	-85.0	-217.7	-180.7	**-148.7**	**-134.2**	**-144.0**
Public finance deficit / GDP**	%, nominal terms	-6.7	-2.8	-3.2	-2.4	-0.7	-2.2	-5.8	-4.8	**-3.8**	**-3.4**	**-3.5**
Public debt (ESA95)	CZK bn, current p.	768.2	847.8	885.4	948.1	1,023.4	1,104.3	1,285.7	1,417.7	**1,557.5**	**1,673.2**	**1,810.7**
Public debt / GDP**	%, nominal terms	28.6	28.9	28.4	28.3	27.9	28.7	34.4	37.6	**40.2**	**42.3**	**43.5**
EXTERNAL RELATIONS												
Current account												
Trade balance	CZK bn, current p.	-69.8	-13.4	48.6	59.3	46.9	25.7	87.3	53.8	**90.0**	**80.0**	**110.0**
Trade balance / GDP	%, nominal terms	-2.7	-0.5	1.6	1.8	1.3	0.7	2.4	1.5	**2.4**	**2.1**	**2.7**
Balance of services	CZK bn, current p.	13.2	16.6	37.9	49.0	59.2	73.9	73.9	75.3	**70.2**	**70.0**	**75.0**
Current account	CZK bn, current p.	-160.6	-147.5	-30.9	-67.1	-156.9	-81.3	-89.3	-116.4	**-119.4**	**-140.0**	**-115.0**
Current account / GDP	%, nominal terms	-6.2	-5.2	-1.0	-2.1	-4.4	-2.2	-2.5	-3.2	**-3.2**	**-3.6**	**-2.8**
Foreign direct investment												
Direct investment	CZK bn, current p.	53.5	101.8	279.6	90.3	179.1	36.3	37.7	97.0	**70.0**	**70.0**	**70.0**
Exchange rates												
CZK/USD	average	28.2	25.7	24.0	22.6	20.3	17.1	19.1	19.1	**17.6**	**17.3**	**16.8**
CZK/EUR	average	31.8	31.9	29.8	28.3	27.8	25.0	26.5	25.3	**24.5**	**23.1**	**22.5**
CZK/EUR	%, y-o-y, real (CPI euro area), avg.	-	0.0	-6.3	-5.1	-2.2	-12.5	5.4	-4.5	**-2.4**	**-5.0**	**-2.5**
CZK/EUR	%, y-o-y, real (PPI euro area), avg.	-	-3.1	-5.5	-1.3	-3.9	-8.8	4.3	-3.1	**-2.9**	**-5.2**	**-2.3**
Foreign trade prices												
Prices of exports of goods	%, y-o-y, average	0.8	3.6	-1.5	-1.2	1.4	-4.6	0.2	-1.0	**1.2**	**-2.2**	**-0.3**
Prices of imports of goods	%, y-o-y, average	-0.3	1.6	-0.5	0.3	-1.0	-3.3	-3.5	2.0	**3.8**	**-2.7**	**-1.5**
MONEY AND INTEREST RATES												
M2	%, y-o-y, average	4.1	7.7	5.3	8.9	11.2	8.4	6.3	4.0	**3.5**	**4.0**	**5.7**
2W repo rate	%, end-of-period	2.00	2.50	2.00	2.50	3.50	2.25	1.00	0.75	-	-	-
3M PRIBOR	%, average	2.3	2.4	2.0	2.3	3.1	4.0	2.2	1.3	**1.1**	**0.9**	**1.4**

* in brackets are constant weights in actual consumer basket
** CNB calculation
– data are not available / forecasted / released
data in bold = CNB forecast

2009				2010				2011				2012				2013			
QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
732.9	729.1	732.9	735.7	741.6	746.0	751.8	755.4	762.0	762.5	764.4	765.4	767.1	770.2	774.6	779.9	784.8	790.1	796.2	802.9
-3.6	-4.8	-4.4	-3.2	1.2	2.3	2.6	2.7	2.8	2.2	1.7	1.3	0.7	1.0	1.3	1.9	2.3	2.6	2.8	3.0
0.6	-0.1	-0.5	-0.9	-0.3	-0.3	-0.2	0.4	-0.4	-0.7	-0.3	-0.1	0.7	1.5	2.1	2.0	2.1	2.0	2.0	2.1
1.4	1.5	4.0	3.4	2.4	0.8	-0.8	-2.6	-1.1	-1.4	-3.5	-1.3	-0.5	0.4	0.9	1.2	0.7	0.0	-0.6	-1.2
-6.1	-13.9	-14.8	-26.5	-7.2	2.8	17.1	10.5	3.6	5.5	-6.8	6.3	3.5	4.9	5.4	5.0	4.6	4.2	3.7	3.2
-19.0	-15.6	-8.0	2.4	18.2	19.4	16.4	16.8	14.8	9.4	7.7	5.9	0.0	3.3	3.6	4.9	6.3	7.7	8.9	9.7
-16.8	-14.5	-6.6	-2.4	15.4	18.5	19.2	17.4	12.7	7.9	2.5	6.0	0.6	4.8	5.4	5.8	6.6	7.4	8.0	8.5
-4.5	15.4	12.9	31.4	14.4	24.1	-5.5	32.2	33.8	38.6	39.1	32.6	28.8	26.1	25.3	26.0	27.9	31.0	35.1	40.0
-19.0	-19.0	-13.2	-2.1	6.9	11.5	10.7	11.8	12.3	9.0	-	-	-	-	-	-	-	-	-	-
-10.8	1.2	0.3	2.0	-22.7	-8.3	-2.8	-2.1	7.0	-4.8	-	-	-	-	-	-	-	-	-	-
-4.3	-5.1	-5.4	-4.0	-0.2	2.1	1.7	1.5	4.8	1.3	-	-	-	-	-	-	-	-	-	-
5.0	3.7	2.1	1.0	0.7	0.6	1.1	1.5	1.7	1.9	1.8	-	-	-	-	-	-	-	-	-
2.2	1.4	0.2	0.4	0.7	1.1	1.9	2.1	1.7	1.8	1.7	2.0	2.7	2.5	2.7	2.8	1.6	1.5	1.5	1.6
11.2	9.8	7.5	5.2	0.8	2.3	3.6	3.8	4.3	4.0	4.5	5.6	7.2	6.9	6.0	5.1	2.9	2.6	2.6	2.5
-0.6	-0.6	-1.5	-0.7	-0.5	-0.3	0.3	0.4	1.0	1.2	1.2	1.2	0.7	0.5	0.9	1.2	1.5	1.6	1.7	1.7
0.0	0.4	-2.0	-2.2	-1.4	-0.2	2.3	2.8	3.2	4.1	3.6	3.2	1.8	1.0	1.2	1.7	1.8	1.6	1.4	1.3
0.6	0.1	-0.5	-0.2	-1.1	-1.2	-1.2	-1.3	-0.8	-0.8	-0.7	-0.5	-0.2	0.2	0.6	0.9	1.4	1.7	1.9	2.1
-20.5	-15.7	-11.8	3.7	18.1	13.3	7.0	8.7	10.8	9.1	9.5	9.9	4.7	0.8	1.4	1.8	-0.2	-0.2	-0.3	-0.7
1.6	1.3	0.2	0.4	-0.3	0.1	0.8	1.0	1.6	1.7	1.7	2.0	1.6	1.4	1.5	1.6	1.6	1.7	1.8	1.8
3.7	3.3	2.1	1.2	-1.7	-1.1	-0.5	-1.4	-1.2	-0.3	0.9	2.7	1.8	0.8	0.6	0.2	2.6	3.0	2.5	2.0
-1.1	-3.6	-5.2	-2.6	-1.4	1.3	2.2	3.0	5.4	6.0	5.6	5.1	3.0	1.5	2.2	2.2	2.1	2.0	1.7	1.7
-27.8	-29.5	-23.8	-16.0	-5.6	-2.8	8.2	22.7	27.9	30.1	16.6	5.0	-5.3	-10.0	-6.7	-4.2	-2.6	-0.9	1.4	2.7
2.8	1.4	0.5	0.3	0.1	-0.2	-0.3	-0.3	-0.4	-0.4	-0.5	-	-	-	-	-	-	-	-	-
-53.3	-51.5	-41.1	33.3	70.5	33.1	11.8	15.8	36.7	49.0	47.3	23.1	0.1	-12.1	-9.2	-5.2	-3.9	-3.2	-3.3	-3.5
2.2	2.5	4.1	4.6	2.6	2.7	1.9	0.6	2.1	2.5	2.5	2.6	3.4	3.6	3.9	4.1	4.1	4.2	4.2	4.2
0.1	1.1	4.0	4.2	1.9	1.5	0.0	-1.5	0.4	0.7	0.7	0.7	0.7	1.1	1.2	1.2	2.5	2.6	2.6	2.6
-0.9	-1.8	-2.8	-2.9	-3.2	-2.6	-1.3	-1.5	-0.1	0.5	0.3	0.7	0.5	0.0	-0.1	-0.1	-0.1	0.0	0.1	0.1
4.9	4.5	4.8	3.0	-1.9	-1.2	0.1	-1.5	-0.9	0.2	1.1	2.0	3.3	2.7	2.4	2.1	1.7	1.6	1.4	1.4
5.5	5.1	5.9	1.2	-5.6	-5.9	-8.2	-6.5	-5.5	-2.0	-	-	-	-	-	-	-	-	-	-
-3.5	-4.2	-3.2	-1.0	3.3	3.9	2.4	2.9	2.4	1.7	1.4	0.9	0.2	0.9	1.3	1.9	2.2	2.4	2.5	2.6
5.8	6.4	7.4	7.3	8.2	7.2	7.1	7.0	7.3	6.8	7.2	7.0	7.2	7.0	7.4	7.0	7.1	6.7	7.0	6.6
7.5	8.1	8.7	9.0	10.1	9.1	8.8	9.1	9.8	8.7	8.4	8.7	9.6	8.6	8.4	8.7	9.3	8.1	7.8	7.9
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
21.6	27.9	19.6	18.3	31.0	22.9	-4.5	4.4	34.1	24.9	13.0	18.0	29.0	26.0	8.0	17.0	36.0	33.0	16.0	25.0
2.5	3.0	2.2	2.0	3.6	2.4	-0.5	0.5	3.8	2.6	1.4	1.8	3.2	2.7	0.8	1.7	3.8	3.2	1.6	2.4
18.1	17.7	18.8	19.3	18.3	24.8	15.3	16.9	13.7	20.5	18.0	18.0	14.0	20.0	18.0	18.0	16.0	21.0	19.0	19.0
9.1	-48.7	-34.8	-14.8	13.9	-27.6	-87.0	-15.7	21.4	-49.8	-73.0	-18.0	13.0	-53.0	-81.0	-19.0	20.0	-48.0	-75.0	-12.0
1.0	-5.3	-3.8	-1.6	1.6	-2.9	-9.4	-1.7	2.4	-5.2	-7.7	-1.8	1.4	-5.5	-8.4	-1.9	2.1	-4.7	-7.4	-1.1
16.5	9.0	-17.1	29.3	30.6	19.5	70.2	-23.3	13.3	35.7	-	-	-	-	-	-	-	-	-	-
21.2	19.6	17.9	17.5	18.7	20.1	19.3	18.2	17.8	16.9	17.3	18.5	17.9	17.4	17.0	16.8	16.8	16.8	16.8	16.8
27.6	26.7	25.6	25.9	25.9	25.6	24.9	24.8	24.4	24.3	24.4	24.8	23.7	23.2	22.9	22.7	22.6	22.5	22.4	22.4
7.4	6.7	6.1	2.1	-6.1	-4.0	-3.1	-4.7	-5.2	-4.2	-1.2	0.9	-2.2	-4.0	-5.6	-8.1	-4.4	-2.7	-1.8	-1.1
8.5	6.1	3.4	-0.6	-6.1	-3.3	-1.1	-2.8	-4.9	-4.6	-1.9	-0.3	-3.0	-4.3	-5.9	-7.7	-4.1	-2.5	-1.5	-0.9
5.2	1.3	-2.2	-3.5	-6.6	-0.3	2.2	1.0	0.8	-0.1	1.4	2.7	-0.3	-2.2	-2.5	-3.7	-1.5	-0.4	0.1	0.5
1.6	-2.9	-7.0	-5.7	-4.5	2.5	5.8	4.7	4.7	2.4	3.4	4.9	0.2	-2.1	-3.3	-5.4	-3.3	-1.7	-0.9	-0.3
8.8	7.5	4.6	4.1	2.8	4.8	4.7	3.8	3.0	2.0	3.7	5.4	4.1	4.2	4.1	3.6	5.9	6.3	5.6	4.9
1.75	1.50	1.25	1.00	1.00	0.75	0.75	0.75	0.75	0.75	0.75	-	-	-	-	-	-	-	-	-
2.7	2.3	2.0	1.8	1.5	1.3	1.2	1.2	1.2	1.2	1.2	1.0	0.9	0.9	0.9	1.0	1.1	1.3	1.5	1.7

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